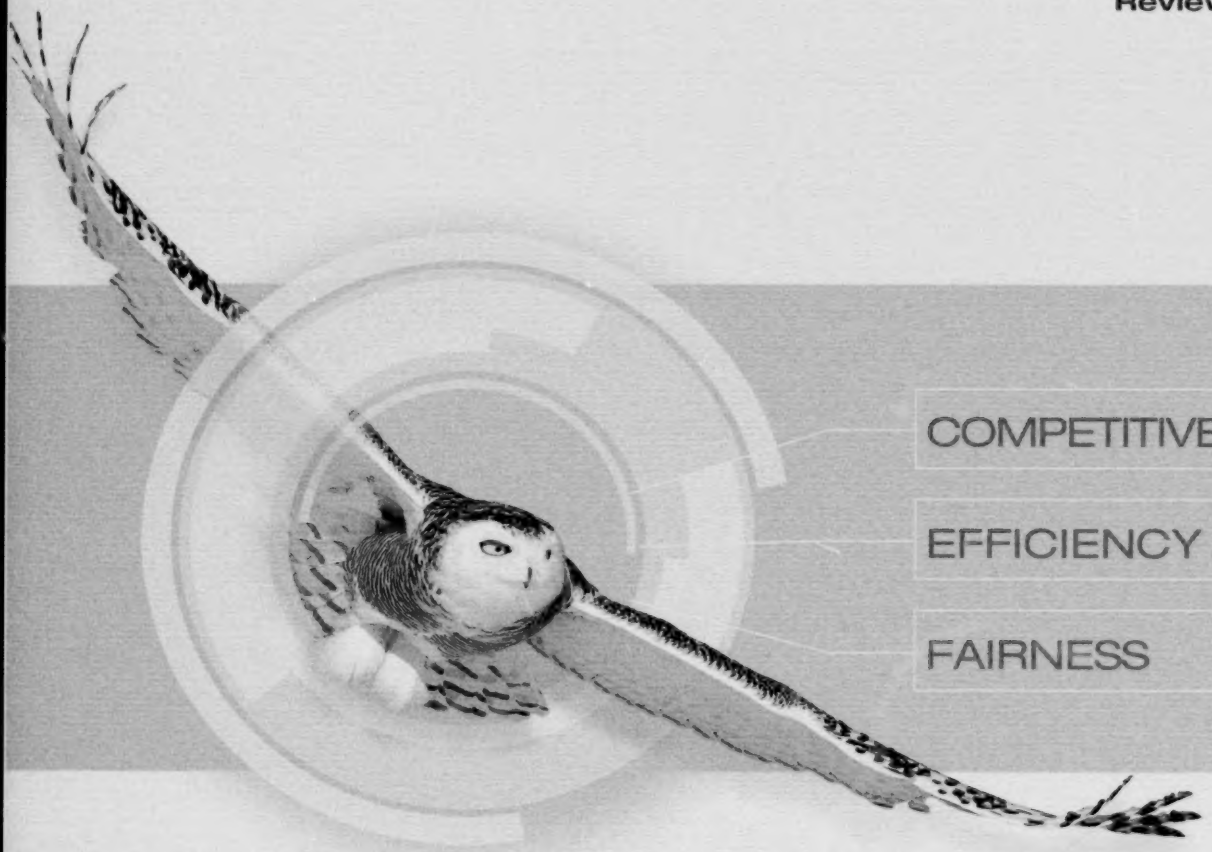
Final Report of the
Québec Taxation
Review Committee



FOCUSING ON QUÉBEC'S FUTURE

VOLUME 2

A Reform
of All Methods of Taxation

Québec

Final Report of the
Québec Taxation
Review Committee

March 2015

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Commission
d'examen
sur la fiscalité
Québec

Final Report of the Québec Taxation Review Committee

FOCUSING ON QUÉBEC'S FUTURE
Volume 2 - A Reform of All Methods of Taxation

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INTRODUCTION

The government established the Québec Taxation Review Committee in June 2014.[1]

At the conclusion of eight months of deliberations, the Québec Taxation Review Committee is submitting its final report, which comprises a summary and six volumes.

Volume 1, ***Québec Tax Reform***, presents the contents of the proposed reform. It examines in turn the challenges, principles and objectives that guided the committee, the key characteristics of the reform, its adjustment over time and an estimate of the anticipated impact.

Volume 1 presents the plan of the six volumes of the report.

❑ Volume 2

Volume 2, ***A Reform of All Methods of Taxation,*** provides details of the proposals formulated in Volume 1, by method of taxation. It presents information and explanations on the committee's proposals, classified according to each taxation method.

It comprises five parts:

— Part 1 examines the proposals pertaining to **personal income tax**.

— Part 2 is devoted to proposals related to **corporate tax**.

— Part 3 presents the proposals concerning **consumption taxes**.

— Part 4 examines proposals respecting **user fees**.

— Part 5 is devoted to proposals that target **tax administration**.

[1] The establishment of the Québec Taxation Review Committee to analyze, and propose the reform of, the Québec taxation system was announced by the Premier in his May 21, 2014 inaugural speech at the opening of the 41st Legislature of the National Assembly, and subsequently confirmed in *Budget 2014-2015*. The order in council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

■ The analysis of tax expenditures

For each method of taxation, the committee analyzed the entire array of tax expenditures associated with it.

To conduct its analysis, the committee applied an analytical grid that enabled it to examine tax expenditures in a coherent, orderly fashion.[2] However, the committee did not confine itself to the simple application of the grid. Whenever a measure demanded it, either in light of its importance or the questions that its modification might raise, the committee engaged in thorough reflection.

Moreover, the committee conducted a specific analysis of certain expenditures, whose implications or importance demanded more extensive analysis.

The document *Dépenses fiscales* published by the Ministère des Finances[3] explains each of the tax measures examined.

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2 Appendix 1 presents the analytical grid that the committee defined.

3 Ministère des Finances du Québec, *Dépenses fiscales – Édition 2013*, March 2014.

PART 1:
PERSONAL INCOME TAX

The committee's recommendations concerning personal income tax are presented in six sections devoted to:

— a streamlined personal income tax rate schedule, including the implementation of additional support measures for the most disadvantaged;

— enhancement of the work premium;

— modification of the refundable tax credit for child assistance;

— establishment of a premium for experienced workers;

— establishment of a "tax shield";

— revision of tax expenditures.

1. A STREAMLINED PERSONAL INCOME TAX RATE SCHEDULE

The weight of personal income tax as a proportion of GDP in Québec is among the highest.[4]

The committee is proposing revision of the current personal income tax rate schedule that would result in a $4.4-billion tax reduction.

This significant personal income tax cut would be achieved by:

— eliminating the health contribution;

— increasing the basic personal amount;

— implementing a general income tax reduction combined with a more progressive tax rate schedule;

— ensuring that the maximum marginal tax rate does not exceed 50%.

Moreover, the committee recommends the enhancement of the solidarity tax credit.

1.1 Elimination of the health contribution

The committee recommends the elimination of the health contribution.

It is difficult to justify this specific tax given that the health contribution is neither indexed to the cost of health services nor determined by the use of services.

Furthermore, the application of the health contribution in addition to the general tax rate schedule engenders inconsistencies in total taxation. Its elimination would eliminate such inconsistencies.

The abolition of the health contribution alone would represent a $734-million personal income tax reduction.

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[4] For additional information, see Part 5 of Volume 3 of this report.

1.2 An increase in the basic personal amount

The committee recommends that the basic personal amount be increased to $18 000.

❑ Shield from tax the first dollars of income earned

The basic personal amount better takes into account the ability to pay and consists in shielding from tax the first dollars of income earned.

To this end, the existing taxation system grants a basic tax credit calculated by applying to a basic personal amount a rate of 20%, i.e. the rate applicable to the second taxable income bracket in the current tax rate schedule.

The committee is proposing that the basic personal amount be raised to $18 000, which would increase from $14 281 to $18 000 the threshold below which a taxpayer does not pay tax.[5]

By contrast, the Centre d'étude sur la pauvreté et l'exclusion estimated in 2013 at $17 000 the low-income cutoff for a person living alone, according to the Market Basket Measure.[6]

❑ A measure that benefits all taxable taxpayers

The basic personal amount applies to all taxpayers regardless of income. All taxable taxpayers would, therefore, benefit from the proposed increase in the basic personal amount, which would represent a $225-million gain for them.

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5 The amount of $14 281 is obtained by multiplying the current basic personal amount of $11 425 by a factor of 1.25, i.e. 20% divided by 16%, to take into account that the rate applicable to the basic personal amount is 20% while that of the first taxable income bracket in the current tax rate schedule is 16%. The rate applicable to the new basic personal amount would be that of the first rate on the proposed tax rate schedule, i.e. 13%.

6 Centre d'étude sur la pauvreté et l'exclusion, *La pauvreté, les inégalités et l'exclusion sociale au Québec : état de situation 2013*, Gouvernement du Québec, 2014, page 9.

1.3 A general income tax reduction combined with a more progressive tax rate schedule

The committee recommends a general income tax reduction combined with a more progressive tax rate schedule.

It recommends that the number of brackets in the Québec tax rate schedule be increased from four to nine to enhance the progressivity of personal income tax.

Lower marginal rates would be reduced. The upper marginal rate would remain unchanged at 25.75% but would apply to a higher income.

The changes would represent an overall personal income tax cut of $3.4 billion.

During the public consultations, several interveners requested that the number of rates in the tax rate schedule be increased and that the progressivity of the tax rate schedule be enhanced. The committee recommends doing so.

1.4 A maximum marginal tax rate of 50%

The committee recommends that the maximum marginal tax rate, including federal taxation, does not exceed 50%.

A high marginal tax rate influences the decision to work.

Instead of proposing a maximum marginal tax rate higher than 50%, the committee has preferred to reduce the tax measures that often benefit the well-to-do. By limiting the application of a maximum marginal tax rate at 50%, we will ensure that taxpayers keep at least half of their additional income.

Recent studies[7] show that taxpayers who fall into the upper brackets of the tax rate schedule are highly sensitive to changes in the marginal tax rate. Estimates of the high sensitivity of taxable income suggests that by increasing the marginal tax rate beyond the 50% threshold, tax revenues could in fact decrease instead of increasing, as one would expect them to.

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7 See Kevin Milligan and Michael Smart, "Taxation and Top Incomes in Canada", NBER Working Paper No. 20 489, September 2014, and Emmanuel Saez, Joel Slemrod and Seth H. Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review" in *Journal of Economic Literature*, Vol. 50(1), March 2012, pages 3-50.

1.5 A comparison of the proposed and existing tax rate schedules

The proposed tax rate schedule would reach its maximum rate at higher levels of income than the current one, i.e. at $150 000 rather than $102 040 and would comprise nine rates instead of four as is now the case.

The main rate reductions would occur in the lowest brackets of the tax rate schedule. The proposed schedule would be more progressive that the existing one.

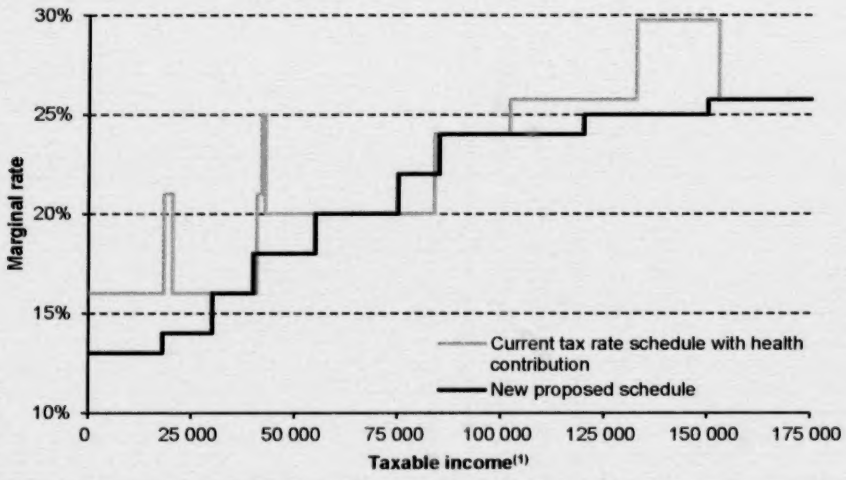
TABLE 1

The new proposed personal income tax rate schedule
(marginal tax rate)

Current tax rate schedule (without the health contribution)		**Proposed tax rate schedule**	
Less than $41 935:	16%	Less than $18 000:	13%
		$18 000 to $30 000:	14%
		$30 000 to $40 000:	16%
$41 935 to $83 865:	20%	$40 000 to $55 000:	18%
		$55 000 to $75 000:	20%
$83 865 to $102 040:	24%	$75 000 to $85 000:	22%
$102 040 or more:	25.75%	$85 000 to $120 000:	24%
		$120 000 to $150 000:	25%
		$150 000 or more:	25.75%

CHART 1

Marginal tax rate (Québec only) according to the proposed and existing tax rate schedules, based on annual taxable income – 2015
(percentage rate and taxable income in dollars)



Note: Does not take into account the basic personal amount.
(1) When the taxpayer does not benefit from additional deductions on net income.

The current tax rate schedule and the health contribution

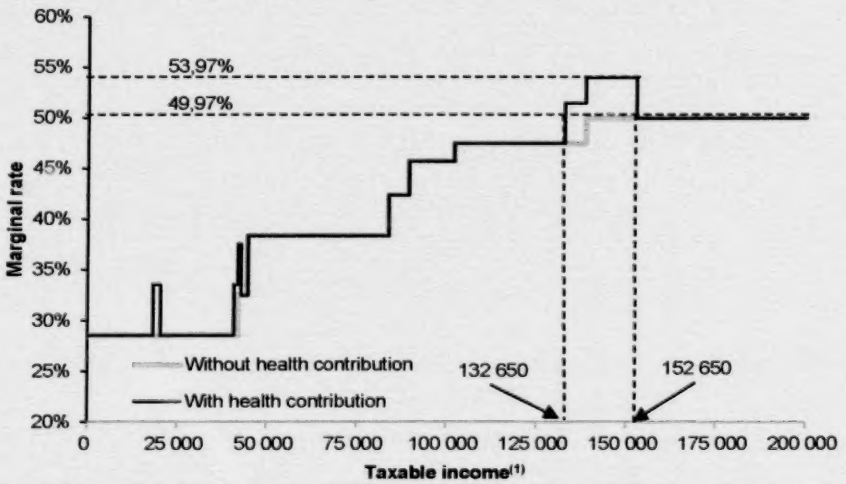
The tax rate schedule

The current Québec tax rate schedule comprises four rates. The maximum marginal tax rate stands at 25.75% for income over $102 040. When federal income tax with a maximum marginal tax rate of 24.22%[1] on income of $138 586 or more is added, the combined maximum marginal tax rate is roughly 50% (49.97%).

The addition of the health contribution

To the tax rate schedule must be added the health contribution in the form of a progressive levy geared to income but that does not follow the tax rate schedule. Beyond an income of $132 650, the health contribution increases gradually from $200 to $1 000 on an income of $152 650, then reaches a ceiling at that amount. When the health contribution is combined with the general tax rate schedule, the marginal rate can reach 54% between $138 586 and $152 650, then fall to 50% when the maximum health contribution is reached.

Marginal tax rate (Québec and federal) including the health contribution, based on annual taxable income – 2015
(percentage rate and taxable income in dollars)



Note: Does not take into account the basic personal amount.
(1) When the taxpayer does not benefit from additional deductions on net income.

Integration into the tax rate schedule

The committee believes that it is more transparent and coherent to directly integrate the health contribution into the tax rate schedule.

In January 2013, part of the health contribution was integrated into the tax rate schedule when the contribution was modified to make it more progressive. Indeed, the maximum marginal tax rate then increased from 24% to 25.75%, which made it possible to recover nearly 40% of the amount of the health contribution before its modification.

(1) Effective rate in Québec after the tax abatement.

1.6 The enhancement of the solidarity tax credit

To protect the most disadvantaged against the deterioration of their financial situation that may result from the proposed new tax mix, the committee recommends the enhancement of the solidarity tax credit.

The proposed increases would be:

— $75 on the base amount, i.e. a 27% enhancement in relation to the current base amount of $278;

— $75 on the spousal amount, i.e. a 27% enhancement in relation to the current spousal amount of $278;

— $50 on the additional amount for a person living alone, i.e. a 38% enhancement in relation to the current additional amount for a person living alone of $133.

The enhancements would represent an additional annual cost for the government on the order of $310 million.

❑ The management of the solidarity tax credit

The committee has examined the Auditor General of Québec's analysis concerning the solidarity tax credit and acknowledges the importance of remedying the shortcomings noted in the administration of the credit.[8]

In particular, the Auditor General's report deplores that the process implemented does not include all of the controls necessary to determine the eligibility of households and ensure that the amounts paid to them correspond to the amounts to which they are entitled.

The committee recommends that the appropriate means be adopted to overcome these significant shortcomings.

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[8] Auditor General of Québec, *Rapport du Vérificateur général du Québec à l'Assemblée nationale pour l'année 2014-2015, Vérification de l'optimisation des ressources*, Spring 2014.

2. THE ENHANCEMENT OF THE WORK PREMIUM

Low- or middle-income workers can benefit from a work premium in the form of a refundable tax credit.

To further reward the work effort, the committee recommends the enhancement of the work premium, which would reinforce the incentive to enter the labour market, especially among last resort assistance recipients.

This recommendation would have a total cost of $107 million.

❑ The work premium

At present, the work premium that is intended for households not subject to any serious constraint to employment applies to work income exceeding $2 400 for a household with only one adult and $3 600 for a household comprising two adults.

The supplementation rates for work income are 7% for persons living alone and childless couples, 25% for couples with children, and 30% for a single-parent families, up to a certain maximum.

Since the work premium is integrated into last resort assistance, the amount of the premium reaches a maximum at the income threshold at which a household that is able to work is no longer eligible for last resort assistance, i.e. $10 370 in the case of a person living alone and $10 056 for a household comprising two adults.

Accordingly, in 2015 the maximum amounts of the premium are $558, $872, $2 391 and $3 114 $, respectively, for a person living alone, a childless couple, a single-parent family and a couple with children.

❑ The proposed enhancement

To further reward the work effort and bolster incentives to join the workforce, in particular among last resort assistance recipients, the committee recommends the enhancement of the work premium.

The supplementation rate of the work premium for households without serious employment limitations would be increased by 2 percentage points for childless households and by 2.5 percentage points for households with children. The supplementation rates for work income would thus be 9% for persons living alone and childless couples, 27.5% for couples with children, and 32.5% for single-parent families.

The work premium would continue to be reducible according to family income subject to a benefit recapture rate of 10% for each dollar of income that exceeds the applicable income threshold, depending on the type of household. The reduction points would remain the same.

The increase in the supplementation rates that the committee is proposing would raise the maximum amounts of the premium in 2015 to $717, $1,121, $2 590 and $3 425, respectively, for a person living alone, a childless couple, a single-parent family and a couple with two children.

A similar enhancement of the supplementation rate would be applied to a household in which there is one adult with serious employment limitations.

The enhancement that the committee is proposing would significantly affect household disposable income. The gains could reach more than $300 for a couple with two children and more than $150 for a person living alone. The enhancement of the work premium would benefit the most disadvantaged.

TABLE 2

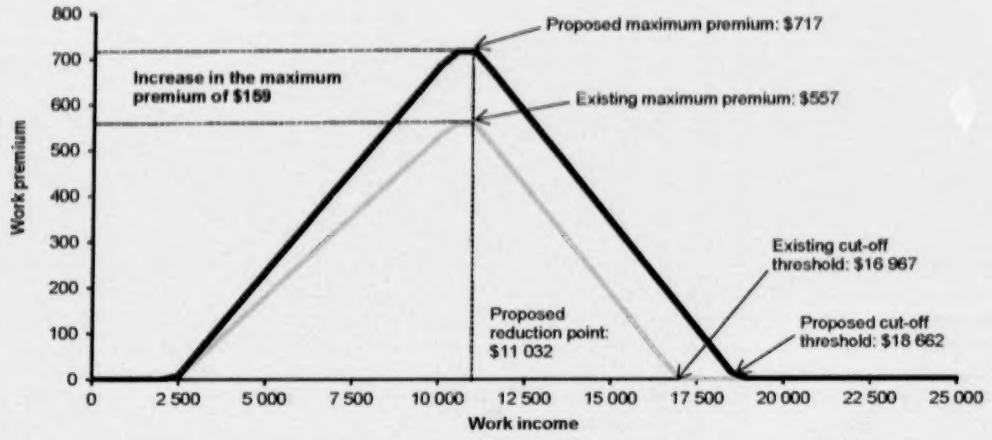
Comparison of the parameters of the existing and proposed work premium

Parameters	Existing premium – 2015	Proposed premium
Supplementation rate		
– Single person	7%	9%
– Childless couple	7%	9%
– Single-parent family	30%	32.5%
– Couple with children	25%	27.5%
Maximum contribution (in $)		
– Single person	557.90	717.30
– Childless couple	871.92	1 121.04
– Single-parent family	2 391.00	2 590.25
– Couple with children	3 114.00	3 425.40
Reduction point of the work premium (in $)		
– Household with one adult	10 370	10 370
– Household comprising two adults	16 056	16 056
Recovery rate of the work premium	10%	10%

CHART 2

Illustration of the proposed work premium in relation to the existing premium, for a person living alone – 2015

($)



3. CHANGES TO THE REFUNDABLE TAX CREDIT FOR CHILD ASSISTANCE

To avoid subjecting low- or middle-income families with children to excessive implicit marginal tax rates, the child assistance measures and the work premium are being integrated.

Accordingly, the income threshold at which the work premium becomes null is equivalent to the threshold at which the refundable tax credit for child assistance becomes reducible according to income. In 2015, the amounts stand at $34 280 for a single-parent family and $47 196 for a couple with children.

❑ Increased thresholds

The enhancement of the work premium that the committee is recommending would be accompanied by changes to the parameters of the tax credit for child assistance.

The income thresholds at which the tax credit becomes reducible according to income would be increased, from $34 280 to $36 273 for a single-parent family and from $47 196 to $50 310 for a couple with children.

❑ The committee's recommendations

In addition to this change, the committee recommends that the reduction rate on the amounts paid pursuant to the refundable tax credit for child assistance decrease from 4% to 3%.

The tax credit for child assistance includes a universal component: beyond a certain threshold, the government pays a minimum amount per child to all eligible families.

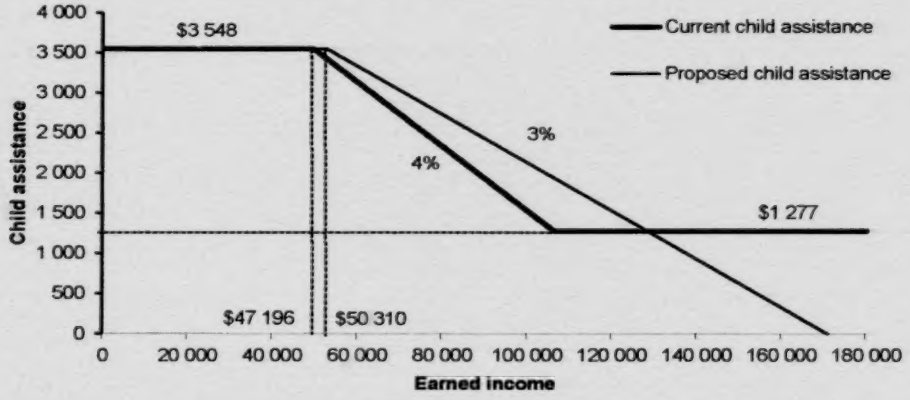
The committee recommends that the universal portion of the credit be eliminated. Couples with two children and incomes higher than nearly $170 000 would no longer receive any amount under the tax credit for child assistance.

The committee is, therefore, proposing that a portion of the amounts paid to well-to-do families under the refundable tax credit for child assistance be reallocated to lower-income families.

The recommendations would have a net cost of $6 million.

CHART 3

Illustration of child assistance for a couple with two children and two equal incomes
($)



4. THE ESTABLISHMENT OF A PREMIUM FOR EXPERIENCED WORKERS

One way to counteract the dwindling labour force is to promote the maintenance on or a return to the labour market by workers approaching retirement or who have already retired, called experienced workers.

To this end, the committee recommends that the tax credit for experienced workers be replaced by a premium for experienced workers that would be added to the work premium. The new tax credit would be a major incentive for experienced workers to remain on or return to the labour market.

The measure would have a total annual cost of $335 million. Bearing in mind the cost of the tax credit for experienced workers that it is replacing, the net cost of the measure would be $275 million.

4.1 The premium for experienced workers

The existing tax credit for experienced workers has only a limited impact since the incentive offered is small. It applies starting at the age of 65 and is non-refundable. It seeks to offset the tax that experienced workers would have had to pay in Québec on a maximum of $4 000 of work income exceeding the first $5 000 collected.

The new premium for experienced workers would apply to work income exceeding $5 000 up to a maximum surplus income of $10 000.

TABLE 3

Comparison of the parameters of the existing and proposed premium for experienced workers

Parameters	Existing tax credit	Proposed premium for experienced workers
Nature of the credit	Non-refundable	Refundable
Eligibility age	65 years of age or over	60 years of age or over
Minimum work income	$5 000 or more	$5 000 or more
Rate of the credit	15.04% bearing in mind the deduction for workers	– 15% for workers 60 to 64 years of age – 25% for workers 65 years of age or over
Maximum surplus income	$4 000 starting in 2015	$10 000
Maximum tax credit	$602 starting in 2015	– $1 500 for workers 60 to 64 years of age – $2 500 for workers 65 years of age or over
Reduction point	None	$30 000
Reduction rate	None	10%
Cut-off threshold	None	– $45 000 for workers 60 to 64 years of age – $55 000 for workers 65 years of age or over

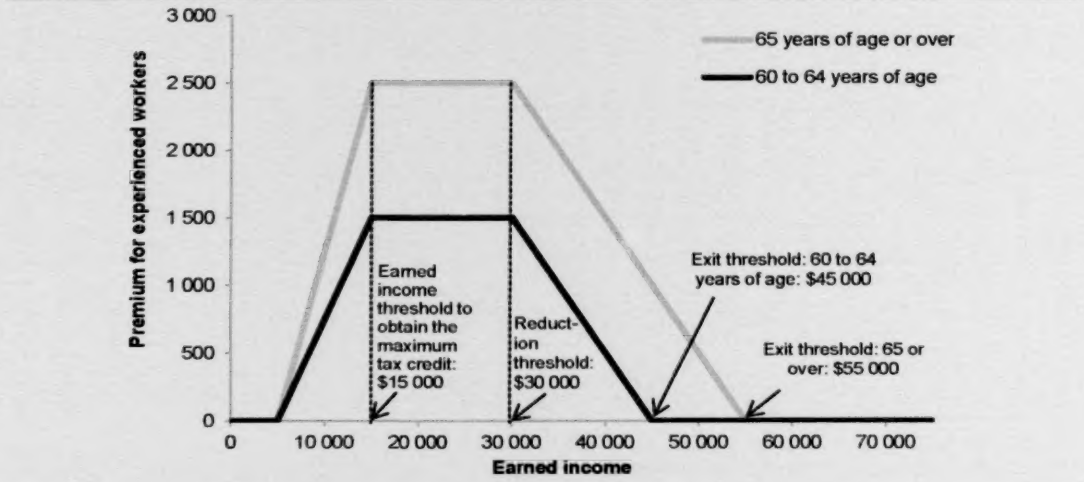
The tax credit would be available at the age of 60. The rate of the tax credit would be 15% starting at the age of 60 and up to the age of 64 for a maximum tax credit of $1 500. The rate would rise to 25% starting at the age of 65 and the maximum tax credit would be $2 500.

Starting with work income of $30 000, the maximum amount would be reduced by 10% for each additional dollar of such income.

Moreover, the premium would apply solely to work income received from taxpayers dealing at arm's length, which would avoid the experienced worker's paying himself or close relations an eligible salary instead of a dividend for the sole purpose of optimizing his tax.

CHART 4

Illustration of the tax assistance that the premium for experienced workers offers a person living alone 60 years of age or over – 2015
($)



4.2 A new incentive for workers between 60 and 64 years of age and more generous assistance for workers 65 or over

The premium for experienced workers would offer a new incentive to work for workers between 60 and 64 years of age. Indeed, such workers are ineligible for the existing tax credit for experienced workers, which is limited to individuals 65 or over. Workers between 60 and 64 years of age are only eligible for the work premium.

Through the premium for experienced workers that the committee is recommending, they would from now on benefit from more generous tax assistance corresponding to a rate of 15% applicable to their annual work income exceeding $5 000. The gain would stand at $750, $1 500 and $500 for individuals with work income of $10 000, $25 000 and $40 000, respectively.

TABLE 4

Comparison of the tax assistance offered by the new premium for experienced workers and the existing tax credit for experienced workers, for a person living alone between 60 and 64 years of age – 2015
($)

	Tax credit for experienced workers		
Work income	**Existing credit**	**Proposed premium for experienced workers**	**Net gain**
0	—	—	—
5 000	—	—	—
10 000	—	750	**750**
15 000	—	1 500	**1 500**
20 000	—	1 500	**1 500**
25 000	—	1 500	**1 500**
30 000	—	1 500	**1 500**
35 000	—	1 000	**1 000**
40 000	—	500	**500**
45 000[1]	—	—	—
50 000	—	—	—
55 000	—	—	—
75 000	—	—	—
100 000	—	—	—

(1) Cut-off threshold for the premium for experienced workers.

For workers 65 years of age or over with annual work income between $10 000 and $45 000, the tax assistance would be more generous than the existing assistance, which could enhance the latters' incentive to work.

The net tax gain, bearing in mind the abolition of the existing tax credit for experienced workers, would in 2015 be $648, $1 898 and $398 per year for individuals with work income of $10 000, $25 000 and $45 000, respectively.

The new premium would be reducible according to income, unlike the existing credit that it would replace. For this reason, workers with incomes of $50 000 or more would sustain losses. The committee believes that it is preferable to offer a more generous premium to individuals with more modest incomes.

TABLE 5

Comparison of the tax assistance offered by the new premium for experienced workers and the existing tax credit for experienced workers, for a person living alone 65 years of age or over – 2015
($)

	Tax credit for experienced workers		
Work income	**Existing credit**	**Proposed premium for experienced workers**	**Net gain**
0	—	—	—
5 000	—	—	—
10 000	602	1 250	**648**
15 000	602	2 500	**1 898**
20 000	602	2 500	**1 898**
25 000	602	2 500	**1 898**
30 000	602	2 500	**1 898**
35 000	602	2 000	**1 398**
40 000	602	1 500	**898**
45 000	602	1 000	**398**
50 000	602	500	**–102**
55 000[1]	602	0	**–602**
75 000	602	0	**–602**
100 000	602	0	**–602**

(1) Cut-off threshold for the premium for experienced workers.

4.3 Anticipated impact

The proposed measure would bolster the work incentive for workers 60 years of age or over who wish to remain active on the labour market by increasing disposable income by an amount of up to $1 500 for workers between 60 and 64 years of age and $2 500 in the case of workers 65 years of age or over.

❑ The enhancement of implicit marginal tax rates

The premium for experienced workers would solve the problem of the high implicit marginal tax rates observed among the beneficiaries of the guaranteed income supplement who earn work income.

Indeed, the factor that has the greatest impact on the implicit marginal tax rates of the elderly is the gradual elimination of the guaranteed income supplement, a federal government transfer aimed at reducing poverty among the elderly.

The amount of the benefits of an individual who is entitled to the guaranteed income supplement is reduced by 50 cents for each dollar of work income, excluding the old age security pension. However, there exists a $3 500 exemption for work income. Since 2011, the guaranteed income supplement has included an additional benefit for very low-income earners. The additional benefit is reduced by 20 cents for each dollar of income beyond the threshold of $2 000, excluding the old age security pension.

Because of their low incomes, nearly one-third of the elderly beneficiaries of the guaranteed income supplement lose half of it even if they do not pay any income tax.[9]

For example, in the case of a worker 65 years of age or over now receiving the regular guaranteed income supplement, the new premium for experienced workers would reduce his implicit marginal tax rate by 25 percentage points for the 2015 fiscal year if he has annual work income of $10 000.

The implicit marginal tax rate would decrease from 58.6% to 33.6%.

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9 Jonathan Rhys Kesselman, *La fiscalité et l'incitation à l'épargne des ménages québécois – Document à l'intention de la Commission d'examen sur la fiscalité québécoise*, November 17, 2014.

❑ Prolong work life by raising the average retirement age

Since the amounts of the premium could be substantial, it could significantly affect the number of workers who decide to remain active on the labour market and to postpone retirement.

Furthermore, since the tax credit is refundable, the premium for experienced workers could be paid in the form of monthly advance payments, which would bolster the incentive to remain on the labour market.

The premium for experienced workers is an additional benefit when retirement is postponed

Through the tax gain obtained by means of the premium for experienced workers, a worker who decides to remain on the labour market could obtain an additional benefit in the future should he postpone the time when he starts to receive the public retirement benefits to which he is entitled.

An example

For example, a taxpayer 65 years of age who has worked all his life for the equivalent of half the maximum pensionable earnings under the Québec Pension Plan, i.e. $26 800 in 2015, would receive $23 155 each year in benefits were he to retire at 65:

- $6 765 in old age security pension;
- $6 390 from the Québec Pension Plan;
- $12 000 from an employee retirement plan.

Were the taxpayer to delay for two years his retirement, he would receive from the Québec government a premium for experienced workers of $2 500 in addition to his wages of $26 800, i.e. a total of $29 300 for each of the two years.

What is more, if he postpones for two years the payment of his public retirement benefits, the latter would increase by more than $2 000 for each year until his death in order, among other things, to compensate the shorter period during which he receives retirement benefits.

In this situation, the annual enhancement received would be:

- $974 for the old age security pension;
- $1 074 for the Québec Pension Plan benefit.

Accordingly, the taxpayer would have higher income not only for the two years of additional work but for all of the subsequent years until his death since the total amount of his benefits would increase from $23 155 to $25 203 per year.

4.4 The premium for experienced workers reflects foreign initiatives

A number of researchers have highlighted factors that discourage work to which experienced workers may be subject. Various research findings suggest that a measure such as the one that the committee is proposing could have a positive impact in this respect. Australia, the Netherlands and Sweden apply tax provisions akin to the premium that the committee is proposing.

In the 1990s, research conducted in various countries showed that financial incentives can influence whether or not workers decide to remain on the labour market.[10] Canadian researchers have also concluded that the financial provisions in the Canadian taxation system that discourage work appear to have a negative impact on retirement age.[11]

Other studies have shown that lower reduction rates in respect of certain benefits paid to the elderly have a positive impact on their participation in the labour market, in Canada, the United States and the United Kingdom.[12]

Lastly, in a report focusing on employment and taxation, the OECD concludes that the tax system has a significant impact on the work-related decisions of the elderly.[13] In its report, the OECD suggests different avenues to enhance the tax system in this respect, including the introduction of a tax credit.

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10 Jonathan Gruber and David A. Wise, *Social Security and Retirement around the World*, The University of Chicago Press, National Bureau of Economic Research, 1999.

11 Michael Baker, Jonathan Gruber, and Keven Milligan, "The Retirement Incentive Effects of Canada's Income Security Programs" in *Canadian Journal of Economics*, Vol. 36, No. 2, 2003, pages 261-290.

12 Michael Baker and Dwayne Benjamin, "How Do Retirement Tests Affect the Labour Supply of Older Men?" in *Journal of Public Economics*, Vol. 71, No. 1, 1999, pages 27-52; Steven Haider and David S. Loughran, "The Effect of the Social Security Earnings Test on Male Labor Supply – New Evidence from Survey and Administrative Data" in *Journal of Human Resources*, 2008, Vol. 43, No. 1, pages 57-87; Richard Disney and Sarah Smith, "The Labour Supply Effect of the Abolition of the Earnings Rule for Older Workers in the United Kingdom" in *The Economic Journal*, Vol. 112, No. 478, 2002, pages 136-152. See also the research of Alexandre Laurin and Finn Poschmann, "Que sont devenus les taux effectifs marginaux d'imposition des Québécois?" in *Cyberbulletin*, C. D. Howe Institute, and that of Keven Milligan and Tammy Schirle, "Improving the Labour Market Incentives of Canada's Public Pensions" in *Canadian Public Policy*, Vol. 34, No. 3, 2008, pages 281-303.

13 OECD, *Taxation and Employment – OECD Tax Policy Studies*, No. 21, OECD Publication, 2011.

Some initiatives to encourage experienced workers in certain OECD countries

Different countries have implemented initiatives to encourage experienced workers to remain on or return to the labour market. The committee has selected several examples.

Australia

Australia offers a non-refundable tax credit to the elderly 55 years of age or over who earn income from remunerated work. The credit is equivalent to 5% of the first AUD$10 000 of work income—roughly CAD$9 800—for a maximum of AUD$500.

Starting on work income of AUD$53 000—roughly CAD$52 000—the credit is reducible according to income.

The Netherlands

The Netherlands also offers a tax credit for workers 61 years of age or over. The credit is offered to individuals with work income of at least €8 860—roughly CAD$12 300.

The tax credit varies according to age: it is 5%, 7% and 10% for elderly people 61, 62 and 63 years of age, respectively. The amounts of the credit paid may not exceed €2 296, €3 214 and €4 592 for elderly people 61, 62 and 63 years of age, respectively. The maximums are reached when work income totals €54 776—roughly CAD$76 000.

In the case of individuals 64 years of age or over, the credit is less generous, both from the standpoint of the rate and the maximum amounts.

The tax credit for elderly workers is not reducible according to income.

Sweden

In Sweden, the non-refundable credit on work income is more generous for individuals aged 65 years or over. The amount of the credit is complex to determine: not only does the rate of the credit vary according to income but also the base amount used to calculate the credit depends on the amount of certain transfers received. The credit corresponds to roughly 10% of the first 300 000 Swedish kronor of work income—roughly CAD$44 000.

As is the case in the Netherlands, the credit is not reducible according to income.

Note: Currency conversions in Canadian dollars were made at the rate in force in January 2015.
Source: OECD, *Taxation and Employment – OECD Tax Policy Studies*, No. 21, OECD Publication, 2011.

5. THE ESTABLISHMENT OF A "TAX SHIELD"

The Québec and federal taxation systems offer low-income households significant assistance in the form of transfers.

Such assistance is reducible according to income, which means that when their income increases, certain taxpayers face not only higher tax payable but also a reduction in certain transfers from which they benefit. This leads to a high implicit marginal tax rate for taxpayers that fall into certain income brackets, thereby reducing the incentive to work.[14]

— To tackle the problem of high implicit marginal tax rates, the committee recommends the establishment of a "tax shield" intended to reduce the implicit marginal tax rate tied to an annual increase in work income. The measure would cost $90 million.

— The "tax shield" would in fact have an impact on the implicit marginal tax rate and such impact would depend on family status and work income.

5.1 The "tax shield"

The "tax shield" would take the form of a 50% deduction of the increase in work income up to a maximum increase of $5 000 per household. It would reduce the taxpayer's net income, thereby creating an adjusted net income used to calculate the following socio-fiscal credits:

— the work premium, including its enhancement and the new premium for experienced workers that the committee is recommending;

— the solidarity tax credit;

— the tax credit for childcare expenses.

The "tax shield" would thus allow households that increase their work income to protect themselves from a marked increase in their tax burden by limiting the loss of the refundable tax credits reducible according to income. It could apply each year to the increase in work income in relation to the preceding year.

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[14] For additional information, see Part 5 of Volume 3 of this report.

Determination of the "tax shield"

The implementation of the "tax shield" would take the form of a deduction applicable to income used to determine the amounts paid in respect of the work premium (including the premium for experienced workers that the committee is proposing), the solidarity tax credit and the tax credit for childcare expenses.

The tax benefit would correspond to the gains stemming from a smaller reduction in the socio-fiscal transfers to which the household is entitled.

Eligibility for the "tax shield"

Any household whose work income increased in relation to the preceding year could take advantage of the income adjustment offered by the "tax shield."

Determination of the adjusted income

Each eligible household could deduct from its net income an amount equivalent to 50% of the increase in its work income up to a maximum of $5 000. The maximum adjustment of net income would thus be $2 500 per household.

Application for a couple

The benefits paid pursuant to the work premium—including the premium for experienced workers that the committee is proposing—the solidarity tax credit and the tax credit for childcare expenses would be determined according to net family income. Accordingly, the net family income adjusted for a couple would be equivalent to the sum of the individuals' net adjusted income.

For the purpose of calculating the socio-fiscal credits, a couple might be entitled to deduct from its net family income[1] an amount up to $2 500 if the sum of the increase in its work income is $5 000 or more.

For example, a household in which the two adults increase their work income by $3 000 and $2 000, respectively, would benefit from a $2 500 reduction in net family income.

Application for a person living alone

Again for the purpose of calculating the socio-fiscal credits, a person living alone might be entitled to deduct from his net income an amount up to $2 500 if his work income increases by $5 000 or more.

1 Unlike the other measures, the premium for experienced workers is reduced according to work income. Accordingly, the deduction would apply to work income and not net income.

5.2 The impact of the "tax shield"

We estimate that nearly 790 000 households could benefit from the "tax shield."

The total gain for such households would be nearly $90 million.

The measure would essentially benefit taxpayers with family incomes under $75 000.

TABLE 6

Number of potential beneficiaries of the "tax shield" and total gains for households
(in number and in millions of dollars)

Measures considered for the "tax shield"	Clientele targeted	Gains[1]
Work premium[2]	353 356	51.5
Solidarity tax credit[3]	449 321	32.2
Tax credit for childcare expenses	59 006	2.4
Premium for experienced workers proposed by the committee	35 484	3.7
"TAX SHIELD" MEASURE	**787 805**	**89.8**

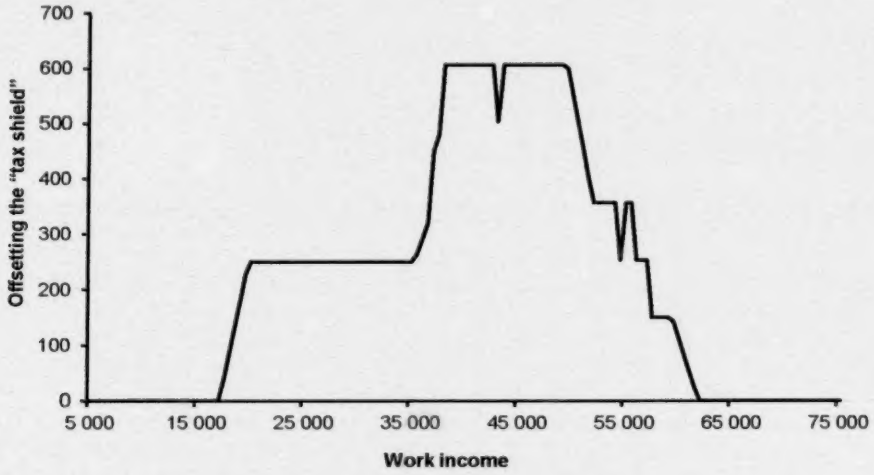
(1) The financial impact takes into account the abolition of the deduction for workers that the committee is proposing.
(2) Taking into account the enhancement of the supplementation rates of the work premium that the committee is proposing.
(3) Taking into account the enhancement of the QST component that the committee is proposing.

❑ The impact of the "tax shield" according to work income

The benefit obtained through the "tax shield" would depend on family status and work income.

CHART 5

Financial impact of the "tax shield" for a couple with two children 3 and 5 years of age whose work income increases by $5 000 – 2015
($)



❑ The example of a couple with two children

The example adopted is that of a couple with two children that receives benefits in respect of the work premium, the solidarity tax credit and the tax credit for childcare expenses.

The family's work income would increase from $40 000 in 2014 to $41 000 in 2015.

In the absence of the "tax shield" and in the wake of a $1 000 increase in work income, the couple's implicit marginal tax rate would reach 61.3%, without taking into account federal taxation.

By limiting the reduction of the socio-fiscal transfers from which the couple benefits, the "tax shield" would avoid unduly penalizing individuals who succeed in increasing their work income. Accordingly, under the "tax shield," the same couple's implicit marginal tax rate would fall from 61.3% to 43.0%, a reduction of 18.3 percentage points.

TABLE 7

Impact of the "tax shield" for a couple with family income of $41 000 and whose work income increases by $1 000 – 2015, without federal taxation
($)

	Change in disposable income		
	Without the "tax shield"	With the "tax shield"	Difference
Additional work income	**1 000**	**1 000**	**—**
Tax payable	**–160**	**–160**	**—**
Required contributions[1]	**–190**	**–190**	**—**
Change in transfers			
– Work premium[2]	–100	–50	50
– Solidarity tax credit[3]	–60	–30	30
– Tax credit for childcare expenses	–103	—	103
Subtotal – Change in transfers	**–263**	**–80**	**183**
Total tax, contributions and change in transfers	**–613**	**–430**	**183**
Implicit marginal tax rate[4] before federal taxation	**61.3%**	**43.0%**	**–18.3%**
Additional income before federal taxation	**+387**	**+570**	**183**

Note: A couple with two children 3 and 5 years of age in a non-subsidized childcare service and two equal incomes.
(1) The drug insurance plan contribution, the Health Services Fund contribution, the health contribution, the Québec Parental Insurance Plan contribution, and the Québec Pension Plan contribution.
(2) Taking into account the enhancement of the supplementation rates of the work premium that the committee is proposing.
(3) Taking into account the enhancement of the QST component that the committee is proposing.
(4) The implicit marginal tax rate is equivalent to the change in disposable income on the $1 000 increase in work income.

❑ The example of a single-parent family

The example adopted is that of a single-parent family with one child 3 years of age using a non-subsidized childcare service.

The family's work income would increase from $35 000 in 2014 to $36 000 in 2015.

Without the "tax shield," the family's implicit marginal tax rate would be 47.3%, without taking into account federal taxation.

The "tax shield" would enable the family in question to reduce its implicit marginal tax rate under Québec's taxation system to 32.8%, a drop of nearly 14.5 percentage points.

TABLE 8

Impact of the "tax shield" for a single-parent family with income of $35 000 and whose work income increased $1 000 – 2015, without federal taxation
($)

	Change in disposable income		
	Without the "tax shield"	**With the "tax shield"**	**Difference**
Additional work income	**+1 000**	**+1 000**	**—**
Tax payable	**–190**	**–190**	**—**
Required contributions[1]	**–58**	**–58**	**—**
Change in transfers			
– Work premium[2]	–100	–50	50
– Solidarity tax credit[3]	–60	–30	30
– Tax credit for childcare expenses	–65	—	65
Subtotal – Change in transfers	**–225**	**–80**	**145**
Total tax, contributions and change in transfers	**–473**	**–328**	**145**
Implicit marginal tax rate[4] before federal taxation	**47.3%**	**32.8%**	**–14.5%**
Additional income before federal taxation	**+527**	**+672**	**145**

Note: A single-parent family with one child in a non-subsidized childcare service.
(1) The drug insurance plan contribution, the Health Services Fund contribution, the health contribution, the Québec Parental Insurance Plan contribution, and the Québec Pension Plan contribution.
(2) Taking into account the enhancement of the supplementation rates of the work premium that the committee is proposing.
(3) Taking into account the enhancement of the QST component that the committee is proposing.
(4) The implicit marginal tax rate is equivalent to the change in disposable income on the $1 000 increase in work income.

❑ The example of a person living alone

Persons living alone would benefit from the "tax shield" to a lesser extent since they would not be eligible for compensation in respect of the tax credit for childcare expenses intended for families.

It should, however, be noted that such individuals have lower implicit marginal tax rates than other types of households, such as couples with children or single-parent families.

For example, the implicit marginal tax rate of a person living alone with work income of $15 000 in 2014 and $16 000 in 2015 would be 20.5% in the absence of the "tax shield" and without taking into account federal taxation.

With the adjustment of the "tax shield," the individual's implicit marginal tax rate would fall to 15.5%, a 5-percentage-point decrease.

TABLE 9

Impact of the "tax shield" for a person living alone with income of $16 000 and whose work income increased $1 000 – 2015, without federal taxation
($)

	Change in disposable income		
	Without the "tax shield"	With the "tax shield"	Difference
Additional work income	**+1 000**	**+1 000**	**—**
Tax payable	**–7**	**–7**	**—**
Required contributions[1]	**–98**	**–98**	**—**
Change in transfers			
– Work premium[2]	–100	–50	50
– Solidarity tax credit[3]	—	—	—
– Tax credit for childcare expenses	—	—	—
Subtotal – Change in transfers	**–100**	**–50**	**50**
Total tax, contributions and change in transfers	**–205**	**–155**	**50**
Implicit marginal tax rate[4] before federal taxation	**20.5%**	**15.5%**	**–5.0%**
Additional income before federal taxation	**+795**	**+845**	**50**

(1) The drug insurance plan contribution, the Health Services Fund contribution, the health contribution, the Québec Parental Insurance Plan contribution, and the Québec Pension Plan contribution.
(2) Taking into account the enhancement of the supplementation rates of the work premium that the committee is proposing.
(3) Taking into account the enhancement of the QST component that the committee is proposing.
(4) The implicit marginal tax rate is equivalent to the change in disposable income on the $1 000 increase in work income.

Possible federal government participation in the "tax shield"

In Québec, the problem of implicit marginal tax rates is only partly attributable to the Québec taxation system. A significant part of the problem stems from the loss of socio-fiscal transfers under the federal taxation system. Federal government participation in the "tax shield" that the committee is proposing would allow eligible households to benefit from higher compensation.

The federal measures eligible for the "tax shield" tied to the objective of encouraging Quebecers to work would be:

- the Working Income Tax Benefit;
- the GST tax credit;
- the National Child Benefit Supplement.

More specifically, the "tax shield" including the federal taxation system would enable the households affected to recover part of the reduction of such transfers. For a family with two children, this would represent an additional reduction in the implicit marginal tax rate of nearly 14 percentage points.

Working Income Tax Benefit

Like the work premium, the Working Income Tax Benefit essentially targets two objectives:

- encourage social assistance beneficiaries to enter the labour market;
- support the additional work effort of individuals who are already employed.

However, the financial assistance is reduced at the rate of 20% on each dollar of income that exceeds a specific threshold according to type of household.

GST tax credit

The GST tax credit is intended to lighten the tax burden of low-income households as regards the tax. As is the case for the solidarity tax credit, a tax increase should not unduly reduce tax assistance for such households in the wake of an increase in work income.

Such assistance is also reducible according to income at a rate of 5% starting on income of $35 466 for 2015.

National Child Benefit Supplement

The National Child Benefit Supplement is offered to low-income families in addition to the Canada Child Tax Benefit paid to families with children under 18 years of age.

The reduction rates of the National Child Benefit Supplement are very high, ranging from 12.2% to 33.3%, depending on the number of children. The recovery of benefits applies on net family income of $26 021 or more for 2015.

In comparison, the recovery rates of the Canada Child Tax Benefit are 2% for families with one child and 4% for other families and apply on net family income of $44 701 or more.

6. REVISION OF TAX EXPENDITURES

The report presents in two sections the findings of the analysis conducted on tax expenditures pertaining to personal income tax and the attendant recommendations.

— The first section presents in an orderly fashion the recommendations concerning most of the tax expenditures analyzed.

— The second section is devoted to measures respecting certain specific tax expenditures, which require a broader explanation.

6.1 Recommendations concerning most of the tax expenditures analyzed

The committee formulated recommendations following the application of the analytical grid that it defined. The recommendations consist in:

— abolishing certain tax measures;

— transforming deductions, exemptions or non-taxation into tax credits;

— terminating the universality of certain tax credits by making them reducible according to income;

— reviewing the application parameters of certain tax expenditures;

— maintaining the status quo as regards other tax measures.

❑ Abolish certain tax measures

The committee recommends that 34 tax measures relating to personal income tax be abolished for various reasons.

■ Measures in respect of which the federal taxation system is sufficient

The committee recommends that the following measures be abolished because it believes that similar measures under the federal taxation system are a sufficient incentive and that a comparable measure under the Québec taxation system is not the best way to attain the objectives:

— tax credit for volunteer firefighters;

— non-taxation of certain amounts paid to emergency services volunteers;

— deduction for a home relocation loan;

— deduction for moving expenses;

— refundable tax credit for youth activities;

In this instance, the amount of allowable expenses for the federal children's fitness tax credit has been doubled, from $500 to $1 000 for the 2015 taxation year. Furthermore, the federal tax credit will become a refundable tax credit.

Data on the federal children's fitness tax credit tax reveal that in 2011, taxpayers earning $50 000 or more accounted for 71% of the amount claimed in respect of the credit.[15] The same year, the concentration of the amount for the artistic activities of children among taxpayers earning more than $50 000 stood at 73%. Accordingly, the tax credit for youth activities primarily benefits well-to-do families. What is more, this type of credit as defined appears to discriminate against certain activities.

— Québec education savings incentive;

It should be noted that the federal government already offers the Canada Education Savings Grant and the Canada Learning Bond, two measures in addition to the preferential tax treatment accorded saving to finance the postsecondary studies of children under the registered education savings plan.

Given that tuition fees in Québec are low, it does not seem warranted for the Québec government to offer an additional incentive.

— non-taxation of benefits granted to an employee by his employer concerning reimbursement of the cost of eligible public transit fares.

The committee wishes to emphasize that the federal government already offers a more comprehensive tax credit.

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15 Canada Revenue Agency, *Statistiques sur le revenu 2013 (Année d'imposition 2011) – TABLE final 2 pour l'ensemble du Canada*, www.cra-arc.gc.ca/gncy/stts/gb11/pst/fnl/pdf/qc/tbl2-fra.pdf.

- **Measures that are hardly relevant or whose objectives would be better achieved by other means**

The committee recommends that other measures be abolished because they seem hardly relevant from the standpoint of the objectives that they are seeking to attain or because such objectives would be better served by the reallocation of funds to other tax or budget measures.

Specifically, the measures focus on:

— deduction for foreign farm workers;

— refundable tax credit for seniors' activities;

— refundable tax credit for top-level athletes;

— tax treatment of amateur athlete trusts;

— depreciation of works of art by a Canadian artist;

— refundable tax credit for respite expenses of informal caregivers;

— refundable tax credit for volunteer respite services;

With regard to the last two credits, the committee wishes to emphasize that the amounts associated with the tax expenditures could be better used by reallocating them to an enhancement of the refundable tax credit for natural caregivers of adults.

— deduction for workers;

Since the federal government offers a similar measure and given that it is costly in relation to its modest results, the committee recommends that the funds generated by the abolition of the deduction be used to better encourage labour market participation through revision of the tax rate schedule, the introduction of the "tax shield," the enhancement of the work premium, and the introduction of the new premium for experienced workers.

- **Little-used measures**

The committee recommends that the following measures be abolished because the number of taxpayers affected by them and the total amounts claimed are negligible:

— deduction for employment outside of Canada;

— deduction in respect of a foreign worker holding a key position in a foreign production;

— tax holiday for Québec seamen;

— income averaging for artists.

- **Measures that no longer serve the purposes for which they were created or are unwarranted**

The committee recommends that the following measures be abolished because they are used for purposes other than those for which they were implemented or they no longer seem relevant from the standpoint of recent changes in society:

— deduction for an artist regarding copyright or similar royalties;

Although the measure may seem legitimate in order to support Québec artists, it appears to be poorly targeted since statements for copyright are sent to taxpayers who are not artists.

— tax credit for contributions to a political party;

This measure no longer seems relevant following revision of the financing rules governing political parties.

— deduction for the residence of members of a religious order.

A tax measure that affects a very small group such as the members of a religious order no longer seems relevant today. Expenses incurred in a home office by members of a religious order would continue to be eligible for a deduction, as is the case for similar expenses incurred by any eligible employee or self-employed worker.

- **Measures that accord unjustified preferential tax treatment**

The committee recommends that the following measures be abolished because it deems the preferential tax treatment accorded certain activities to be unjustified:

— deduction respecting gifts of securities and gifts of securities acquired under a stock option;

The elimination of this measure does not call into question the eligibility of gifts of securities acquired under a stock option. It harmonizes the tax treatment between gifts of securities and gifts from wage income.

— additional deductions for certain exploration expenses regarding flow-through shares;

— deduction for certain flow-through share issue expenses;

To ensure that the flow-through share regime remains similar to that offered in the rest of Canada, the committee recommends that the deduction for flow-through shares be maintained but that the two aforementioned additional measures be abolished.

— additional capital gains exemption in respect of certain resource properties;

This measure seeks to increase the capitalization of mining, oil and gas companies. However, other existing tax measures promote the attainment of this objective.

— non-taxation of death benefits up to $10 000.

This measure is often used for tax planning purposes.

■ Poorly adapted measures that affect the elderly

The committee recommends the abolition of two measures that affect the elderly because it deems them to be poorly adapted to current conditions:

— tax credit for experienced workers;

The work incentives inherent in the existing credit are too limited since the amounts offered are minimal. To replace it, the committee is proposing the creation of an enhanced tax credit in the form of a premium for experienced workers. The parameters of the premium were presented earlier.[16]

— tax credit for retirement income;

The measure was introduced in a different context at a time when poverty among the elderly was more prevalent and the Québec Pension Plan had not been fully established.[17]

The tax benefit that the tax credit confers on taxpayers receiving retirement income, compared with those who do not receive such income, is poorly adapted both from the standpoint of fairness and the work incentive.

The committee recommends other changes to the tax expenditures that affect the elderly, presented later,[18] i.e. pension income splitting and the age tax credit.

■ Unwarranted tax holidays

The committee recommends that tax holidays in respect of certain foreign workers be abolished because it deems to be unwarranted the preferential tax treatment thus accorded such individuals.

Since the tax holidays are temporary, their abolition would not affect those now benefiting from them. They could benefit from them until their anticipated termination.

The tax holidays in question are:

— tax holiday for foreign professors;

— tax holiday for foreign researchers;

— tax holiday for foreign experts;

— tax holiday for foreign specialists employed by a new financial services corporation;

— tax holiday for foreign post-doctoral interns.

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16 See page 19.

17 For additional information, see Part 5 of Volume 3 of this report.

18 See pages 49-50.

TABLE 10

Measures to be abolished– Personal income tax

Measure		Number of applicants in 2011[1]	Financial impact for the government (millions of dollars)
1.	Tax credit for volunteer firefighters	5 123	3
2.	Non-taxation of certain amounts paid to emergency services volunteers	n/a	3
3.	Deduction for a home relocation loan	258	0.02
4.	Deduction for moving expenses	10 955	11
5.	Tax credit for youth activities	—	17
6.	Québec education savings incentive	438 428	65
7.	Measures to encourage the use of public transit - Non-taxation of benefits granted to employees	n/a	8
8.	Deduction for foreign farm workers	5 005	10
9.	Refundable tax credit for seniors' activities	—	5
10.	Refundable tax credit for top-level athletes	2 965	6
11.	Amateur athlete trusts	n/a	n/a
12.	Depreciation of works of art by a Canadian artist	n/a	n/a
13.	Refundable tax credit for respite expenses of informal caregivers	452	0.3
14.	Refundable tax credit for volunteer respite services	181	0.1
15.	Deduction for workers	4 350 275	834
16.	Deduction for employment out of Canada	3 113	7
17.	Deduction in respect of a foreign worker holding a key position in a foreign production	18	0.2
18.	Tax holiday for Québec seamen	89	0.3
19.	Income averaging for artists	32	0.3
20.	Deduction for an artist regarding copyright or similar royalties	8 687	7
21.	Tax credit for contributions to a political party	35 326	2
22.	Deduction for the residence of members of a religious order	1 641	3
23.	Deduction respecting gifts of securities and gifts of securities acquired under a stock option	n/a	n/a
24.	Additional deductions for flow-through shares	n/a	12
25.	Deduction for certain flow-through share issue expenses	1 195	n/a
26.	Additional capital gains exemption in respect of certain resource properties	2 862	4
27.	Non-taxation of death benefits up to $10 000	n/a	n/a
28.	Tax credit for experienced workers	107 125	64
29.	Tax credit for retirement income	1 829 343	191

TABLE 10

Measures to be abolished – Personal income tax

Measure	Number of applicants in 2011[1]	Financial impact for the government (millions of dollars)
30. Tax holiday for foreign professors	329	4
31. Tax holiday for foreign researchers	389	4
32. Tax holiday for foreign experts	118	1
33. Tax holiday for foreign specialists employed by a new financial services corporation	n/a	0.5
34. Tax holiday for foreign post-doctoral interns	68	0.5
Subtotal – Measures abolished		**1 263.22**
Interaction effect		**10.85**
TOTAL		**1 274.07**

n/a: The number of applicants or the financial impact is unavailable because of insufficient or missing data.

(1) The number of applicants does not necessarily correspond to the number of taxpayers who have benefited from the tax expenditure or who are affected by the proposed change. By way of an example, a non-taxpayer does not fully benefit from the measures that he requests. What is more, refundable tax credits may be claimed by one or two taxpayers in a household.

❑ Convert deductions, exemptions or non-taxation into tax credits

The committee recommends that eight deductions, exemptions and non-taxation in respect of personal income tax be replaced by tax credits.

The committee recognizes the importance of taking into account that certain circumstances or expenses reduce taxpayers' ability to pay taxes. However, it is of the opinion that in some instances, such recognition would be more equitable were a tax credit to be granted.

Deductions, exemptions or non-taxation alter the tax base and afford a bigger advantage to those with higher incomes, because of the progressivity of income tax. On the other hand, a tax credit reduces the tax payable by an equivalent amount for everyone, regardless of income.

Deductions and tax credits raise the question of neutrality

The use of deductions, exemptions and non-taxation or partial inclusions is not neutral on the tax base, contrary to tax credits. They modify the tax base and create interactions with other measures. Their value grows with income, according to the applicable marginal tax rate. Accordingly, because of the progressivity of tax, their value is greater for a taxpayer with high income than for a taxpayer with low income.

Conversely, a tax credit reduces the tax payable at a fixed rate, which is usually lower than the maximum marginal tax rate. When a deduction is converted into a credit, some taxpayers win and some lose, depending on the rate adopted for the credit.

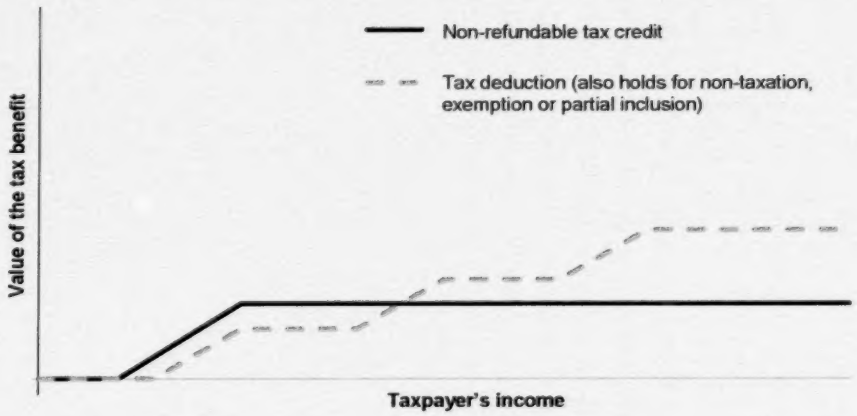
A tax credit recognizes the need to compensate the taxpayer for certain life circumstances or choices, without affecting the application of other tax measures. It also makes it possible to offer an equivalent benefit to all eligible taxpayers regardless of income.

Tax credits offer greater fairness

Since tax credits ensure greater fairness among taxpayers, they should, generally speaking, be preferred to deductions, exemptions and non-taxation. Moreover, several deductions were converted into tax credits in the mid-1980s and early 1990s.

A deduction is sometimes preferable to a tax credit but its use must be justifiable in relation to the impact mentioned. Deductions are often to be emphasized when they recognize an expense incurred to earn income.

Illustration of the benefit offered by a tax credit in relation to a tax deduction, according to the taxpayer's income


Non-refundable tax credit
Tax deduction (also holds for non-taxation, exemption or partial inclusion)
Value of the tax benefit
Taxpayer's income

■ Measures to be converted into non-refundable tax credits

The committee recommends that the following deductions, exemptions and non-taxation be converted into non-refundable tax credits at the rate of 16%:

— deduction for inhabitants of a remote region;

— deduction for members of the Canadian Forces and police officers on deployment;

— deduction of the financial assistance granted to pay tuition fees related to basic training for adults;

— deduction for tradespeople's tool expenses;

— deduction for tool expenses of apprentice vehicle mechanics;

— deduction for goods and services to support a disabled person;

— non-taxation of allowances paid to certain public officers;

— tax exemptions regarding bursaries and awards.

  In addition to the conversion of the exemption into a tax credit, the committee recommends in this instance that the maximum amount of bursaries and awards that entitle the taxpayer to the credit be set at $30 000.

The committee believes that the conversion into tax credits of other deductions, exemptions or non-taxation is unjustified for the sake of the coherence of the taxation system, the matching of income and expenses, harmonization with the federal taxation system, to ensure similar treatment between employees and self-employed workers, or to avoid double taxation.

TABLE 11

Measures to be converted into non-refundable tax credits – Personal income tax

Measure	Number of applicants in 2011[1]	Financial impact for the government (millions of dollars)
1. Deduction for inhabitants of a remote region	28 234	7
2. Deduction for members of the Canadian Forces and police officers on deployment	3 078	0.5
3. Deduction of the financial assistance granted to pay tuition fees related to basic training for adults	n/a	0.05
4. Deduction of financial assistance provided for payment of tuition fees relating to basic adult education	3 051	0.05
5. Deduction for tool expenses of apprentice vehicle mechanics	n/a	0.05
6. Deduction for goods and services to support a disabled person	297	0.5
7. Non-taxation of allowances paid to certain public officers	n/a	0.5
8. Tax exemptions regarding bursaries and awards	125 352	6
Subtotal - Measures to be converted into tax credits		**14.65**
Interaction effect		**0.12**
TOTAL		**14.77**

n/a: The number of applicants or the financial impact is unavailable because of insufficient or missing data.

(1) The number of applicants does not necessarily correspond to the number of taxpayers who have benefited from the tax expenditure or who are affected by the proposed change. By way of an example, a non-taxpayer does not fully benefit from the measures that he requests.

❑ Terminate the universality of certain tax credits by making them reducible according to income

The committee recommends terminating the universality of nine tax credits concerning personal income tax by making them reducible according to income.

The committee recognizes the importance of taking into account that certain circumstances or expenses reduce taxpayers' ability to pay taxes.

However, it believes that beyond a certain income threshold, certain taxpayers and families should not benefit from certain tax credits to enable those with lower incomes to benefit as a priority from them. Indeed, certain situations demand government assistance only for taxpayers whose income warrants such support.

■ Measures to be made reducible according to income

The committee recommends that the following tax credits be converted into tax credits reducible according to income.

Unless otherwise indicated, the credits should be reducible starting on net income of $62 500 for a person living alone and reduced to zero for an individual whose net income reaches $100 000. In the case of couples, the credit would be reduced starting on net family income of $125 000 and reach zero on net family income of $ 200 000.

The cut-offs have been established bearing in mind the problem of high implicit marginal tax rates. The cut-offs selected lie above the income fields in which the implicit marginal tax rates are high. Furthermore, a taxpayer usually simultaneously obtains few of the measures and there is little or no cumulative impact.

Specifically, the measures focus on:

— tax credit respecting the essential needs of minor children engaged in vocational training or post-secondary studies;

— tax credit respecting the essential needs of other dependants;

— transfer of the recognized parental contribution;

  At present, only the dependant's income is considered in the calculation of the three tax credits.

— tax credit for tuition fees and examination fees, and possible transfer of unused portion to the parents or the grandparents;

— tax credit for persons with a severe and prolonged impairment in mental or physical functions;

  The tax credit is not currently refundable. Initially, the committee recommends that it be made refundable so that the most disadvantaged are entitled to it. The tax credit would ultimately be more generous.

— transfer of non-refundable tax credits not used by a spouse;

— tax credit for new graduates working in a remote resource region;

— tax credit for interest paid on student loans;

The committee also recommends that the rate used for this tax credit be reduced to 16%.

— refundable tax credit for adoption expenses.

This tax credit should be made reducible according to the same income criteria as those applicable to the tax credit for the treatment of infertility, following the changes announced in December 2014 in the *Update on Québec's Economic and Financial Situation*.

TABLE 12

Measures that should no longer be universal – Personal income tax

Measure	Number of applicants in 2011[1]	Financial impact for the government (millions of dollars)
1. Tax credit respecting the essential needs of minor children engaged in vocational training or post-secondary studies	13 058	1.0
2. Tax credit respecting the essential needs of other dependants	31 880	1.8
3. Transfer of the recognized parental contribution	66 320	11.4
4. Tax credit for tuition fees and examination fees, and possible transfer of unused portion	136 076	12.2
5. Tax credit for persons with a severe and prolonged impairment in mental or physical functions	96 470	–23.0
6. Transfer of non-refundable tax credits not used by a spouse	n/a	26.3
7. Tax credit for new graduates working in a remote resource region	27 094	2.9
8. Tax credit for interest paid on student loans	151 907	2.5
9. Refundable tax credit for adoption expenses	536	1.0
Subtotal – Measures that should no longer be universal		**36.10**
Interaction effect		**0.64**
TOTAL		**36.74**

n/a: The number of applicants or the financial impact is unavailable because of insufficient or missing data.

(1) The number of applicants does not necessarily correspond to the number of taxpayers who have benefited from the tax expenditure or who are affected by the proposed change. By way of an example, a non-taxpayer does not fully benefit from the measures that he requests. What is more, refundable tax credits may be claimed by one or two taxpayers in a household.

❑ Review the application parameters of certain tax expenditures

The committee recommends that the application parameters of nine tax credits relating to personal income tax be reviewed.

It is not calling into question the relevance of the tax credits. However, it believes that certain rules must be tightened in order to limit the benefits associated with the credits to individuals with the greatest need or to harmonize the rates of certain credits. The proposed revision can sometimes lead to the enhancement of the credit.

■ Measures whose parameters must be revised

The committee recommends that the application parameters of the following measures be revised:

— refundable tax credit for childcare expenses;

Except for dependent children with a mental or physical disability, the maximum age of children entitled to the refundable tax credit for childcare expenses should be lowered from 16 to 14 years of age. The tightening measure would add to the proposed changes to the same tax credit in conjunction with the taxation of childcare expenses that the committee is proposing.[19]

— tax credit for gifts;

The tax credit now entitles the taxpayer to a rate of 20% on the first $200 of gifts and 24% on the amount of additional gifts. Bearing in mind that the sacrifice of giving a $200 gift for a low-income individual is at least equivalent to the sacrifice of giving a bigger gift for a high-income earner, the committee recommends that a uniform tax credit of 24% be applied, regardless of the amount, thereby enhancing the existing credit.

— non-taxation of certain non-monetary benefits relating to an employment;

The committee recommends the status quo for this measure, except for one very specific aspect, i.e. the elimination of the provision making non-taxable the benefit of a vehicle provided by the employer for the officers of all police forces or fire safety services. The latter are the only ones to now benefit from such treatment since for other taxpayers it is a taxable benefit.

— retirement income splitting between spouses;

The maximum amount that can be split should be limited to $25 000. Furthermore, the eligibility age for splitting should be increased gradually to 75 years of age. Accordingly, the eligibility age should be raised by one year each year until the age of 75 such that the individuals who are now eligible continue to be so. The eligibility age should then be reviewed periodically to reflect changes in life expectancy.

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[19] See page 163.

— tax credit with respect to age;

The use of a simple age criterion to offer tax relief regardless of the financial capacity of the taxpayers targeted seems unwarranted. This criticism has for many years been expressed frequently.

However, the committee is aware of the consequences that an immediate change would have on taxpayers who are already benefiting from the measure. It is, therefore, recommending that the eligibility for the tax credit be raised gradually from 65 to 75 years of age so that current beneficiaries continue to benefit from it. To this end, the eligibility age should be raised by one year each year until the individual reaches the age of 75.

It should be noted that in this age group, individuals who decide to remain on the labour market or to return to it would be entitled to the new premium for experienced workers that is more generous than the existing tax credit for experienced workers.

— refundable tax credit for home-support services for seniors;

The rate of the refundable tax credit should be maintained at 32%, which was the rate applicable in 2014.

The list of allowable expenses should be revised to include expenses that are only slightly related to home support. The annual ceilings on allowable expenses would not change.

The eligibility age of 70 should be raised gradually to 75 years of age for autonomous individuals in order to better coincide with the time at which the loss of autonomy becomes more frequent. Accordingly, the eligibility age should be raised by one year each year until the age of 75 such that the individuals who are now eligible continue to be so. The eligibility age should then be reviewed periodically to reflect changes in life expectancy.

The tax credit is reducible according to income. However, the low reduction rate of 3% means that individuals in households whose family income exceeds $250 000 may benefit from it. The committee recommends that the reduction rate of the credit be raised from 3% to 5% and that it be increased to 15% beyond net family income of $125 000.

— Refundable tax credit for the acquisition or rental of property intended to help seniors live independently longer—refundable tax credit in respect of costs incurred by seniors for a stay in a functional rehabilitation transition unit

For the sake of simplification, the tax credits should be integrated into the refundable tax credit for home support.

— expenses incurred to earn investment income.

Deductible financial expenses should be limited to the amount of investment income bearing in mind the dividend actually received instead of the grossed-up dividend. Taxation statistics indicate that the use of the deduction for financial expenses is more widely used by taxpayer with high incomes.

Since 2003, the deductibility of financial expenses may not exceed the investment income produced during the year. When the financial expenses exceed investment income, the surplus can be carried back to the three preceding years or forward to the 20 subsequent years. This regime is stricter than the federal one or the regimes in the other Canadian provinces. For the sake of matching income and expenses and should the capital gain be fully taxable as the committee recommends,[20] there would be no reason to further tighten this deduction.

TABLE 13

Measures to be revised – Personal income tax

Measure	Number of applicants in 2011[1]	Financial impact for the government (millions of dollars)
1. Refundable tax credit for childcare expenses	433 592	2.3
2. Tax credit for gifts	1 340 036	−6.5
3. Non-taxation of certain non-monetary benefits relating to an employment	n/a	n/a
4. Refundable tax credit for home support for seniors	235 140	50.0
5. Refundable tax credit for the acquisition or rental of property intended to help seniors live independently longer	n/a	−0.3
6. Refundable tax credit in respect of costs incurred by seniors for a stay in a functional rehabilitation transition unit	n/a	−0.2
7. Retirement income splitting between spouses	260 791	52.5
8. Age tax credit	2 012 243	120
9. Expenses incurred to earn investment income	204 596	2
Subtotal – Measures to be revised		**219.80**
Interaction effect		**1.89**
TOTAL		**221.69**

n/a: The number of applicants or the financial impact is unavailable because of insufficient or missing data.

(1) The number of applicants does not necessarily correspond to the number of taxpayers who have benefited from the tax expenditure or who are affected by the proposed change. By way of an example, a non-taxpayer does not fully benefit from the measures that he requests. What is more, refundable tax credits may be claimed by one or two taxpayers in a household.

[20] For additional information, see Part 2 of Volume 1 of this report.

❑ Maintain the status quo as regards other tax measures

The committee recommends that the status quo be maintained as regards 68 tax expenditures pertaining to personal income tax, for various reasons.

For the sake of the coherence of the taxation system, matching income and expenses, harmonization with the federal taxation system, to ensure similar treatment between employees and self-employed workers, or to avoid double taxation, the committee recommends the status quo in respect of certain measures.

■ Measures that avoid double taxation

The committee recommends that the status quo be maintained with regard to the measures aimed at avoiding double taxation:

— non-taxation of capital dividends;

— foreign tax credit;

— credit for tax paid to another province;

— credit for the beneficiary of a designated trust;

— amount exempted from tax under a tax treaty.

■ Measures that recognize certain employment-related expenses or that ensure similar treatment between employees and self-employed workers

The committee recommends that the status quo be maintained with respect to measures that recognize employment-related expenses or reimbursements of expenses incurred that ensure, in particular, similar treatment between employees and self-employed workers:

— deduction of certain employment-related expenses;

— deduction for musicians and artists;

— non-taxation of certain amounts paid to a member of a board of directors or different committees.

■ Measures to ensure the coherence of the taxation system

The committee recommends that the status quo be maintained with respect to the measures aimed at ensuring the coherence of the taxation system or avoiding certain undesirable tax consequences stemming from specific situations:

- retroactive lump-sum payment averaging mechanism;
- non-taxation of the guaranteed income supplement and spouse's allowance;
- non-taxation and deduction for the employees of certain international organizations;
- partial non-taxation of US social security benefits;
- non-taxation of the income of Indians on a reserve;
- non-taxation of income from War Savings Certificates;
- non-taxation of the indemnity paid to a research subject;
- assistance for prospectors and grubstakers;
- non-taxation of allowances for diplomats and other government employees posted abroad;
- non-taxation of certain contributions paid by the employer:
  - employment insurance contributions;
  - parental insurance contributions (deduction in the case of self-employed workers);
  - contributions paid to the Québec Pension Plan (deduction in the case of self-employed workers);
- non-taxation of certain benefits of a public compensation regime that constitutes a form of insurance or other forms of benefits:
  - benefits from a public compensation plan for occupational accidents;
  - benefits from a public compensation plan for traffic accidents;
  - benefits from a public compensation plan for crime victims;
  - income from indemnities for physical or mental injury;
  - social assistance payments;
  - certain pensions and indemnities paid to RCMP officers;
  - income support benefits, pensions, allowances or war indemnities paid to veterans and civilians;
  - certain indemnities paid to military personnel and veterans;
  - financial assistance for childcare services granted by employment assistance programs;
  - strike benefits.

■ Measures necessary for harmonization or that cannot be modified

The committee recommends that the status quo be maintained with respect to measures that must remain harmonized with the federal taxation system or in respect of which modification is impossible for legal reasons or to maintain the system's simplicity:

— the treatment of capital gains that allows for their taxation at the time of realization;

— the $1 000 exemption of capital gains realized at the time of sale of property for personal use;

— the exemption of $200 on capital gains realized on foreign exchange;

— the registered retirement savings plan;

— the registered disability savings plan;

— the non-taxation of investment income from a tax-free savings account;

— the deferral of taxation on wages in conjunction with deferred salary;

— the deferral attributable to the 10-year reserve for capital gains at the time of sale to children of the shares of a corporation that operates a small enterprise;

— the basic deduction for flow-through shares;

— family trusts;

— the non-taxation of gifts and bequests;

— the non-taxation of winnings from lotteries or gambling.

■ Measures aimed at farming and fishing

The committee recommends that the status quo be maintained with regard to certain measures concerning farmers and fishermen:

— exemption from making quarterly remittances;

— possibility of deferring capital gains (transfer to children or 10-year reserve);

— farm losses of part-time farmers.

■ Measures concerning capital gains

The committee recommends that the status quo be maintained with regard to certain measures concerning capital gains deferral:

— through a transfer between spouses;

— by means of a five-year reserve.

■ Measures pertaining to gifts

The committee recommends that the status quo be maintained with respect to certain tax measures pertaining to gifts because of the ecological or cultural value associated with such gifts:

— reduction in the capital gains inclusion rate stemming from a gift of property with undeniable ecological value;

— non-taxation of gains related to gifts and other transfers of cultural property;

— non-taxation of gains related to gifts of musical instruments;

— additional tax credit of 25% for an initial large cultural donation;

— tax credit for cultural patronage.

The last two credits were introduced recently and should, however, be re-examined in five years in light of the outcomes obtained.

- **Measures deemed to be relevant as regards the objective that they pursue**

The committee recommends that the status quo be maintained with respect to other measures deemed to be relevant because of the objective that they pursue and whose characteristics do not require their modification:

— tax credit for union and professional dues;

— tax credit for dues paid to artistic associations;

The committee has noted that the two tax credits were modified in the December 2014 *Update on Québec's Economic and Financial Situation* and it is not proposing other modifications.

— refundable tax credit for informal caregivers of adult persons;

— tax treatment of spousal alimony and maintenance payments;

— tax credit respecting the essential needs of persons living alone;

— non-refundable tax credits related to medical care;

— refundable medical expense tax credit;

— non-refundable tax credit for medical care not provided in the region of residence;

— non-inclusion of the Universal Child Care Benefit in the calculation of tax credits determined according to income;

— refundable tax credit for the supplement for children with disabilities;

— the work premium adapted to individuals with severely limited capacity for employment;

— the supplement for long-term beneficiaries leaving last-resort financial assistance or the Youth Alternative Program;

— deferral of the taxation of an eligible dividend;

— tax credit for infertility treatments;

— the Cooperative Investment Plan;

— the LogiRénov tax credit.

TABLE 14

Measures that must remain unchanged – Personal income tax

Measure	Number of applicants in 2011[1]	Cost in 2013 (in millions of $)
1. Non-taxation of capital dividends	n/a	n/a
2. Foreign tax credit	3 113	29
3. Credit for tax paid to another province	n/a	f
4. Credit for the beneficiary of a designated trust	n/a	n/a
5. Amount exempted from tax under a tax treaty	36 810	34
6. Deduction of certain employment-related expenses	158 823	120
7. Deduction for musicians and artists	n/a	n/a
8. Non-taxation of certain amounts paid to a member of a board of directors or different committees	n/a	f
9. Retroactive lump-sum payment averaging mechanism	n/a	3
10. Guaranteed income supplement and spouse's allowance	n/a	47
11. Non-taxation and deduction for the employees of certain international organizations	1 093	15
12. Partial non-taxation of US social security benefits	n/a	f
13. Non-taxation of the income of Indians on a reserve	21 308	57
14. Non-taxation of income from War Savings Certificates	n/a	n/a
15. Non-taxation of the indemnity paid to a research subject	n/a	n/a
16. Assistance for prospectors and grubstakers	n/a	f
17. Non-taxation of allowances for diplomats and other government employees posted abroad	n/a	n/a
18. Non-taxation of employment insurance contributions	n/a	478
19. Non-taxation of contributions paid by the employer to parental insurance and deduction in the case of self-employed workers	3 894 768	221
20. Non-taxation of contributions paid by the employer to the Québec Pension Plan and deduction in the case of self-employed workers	3 827 589	1 148
21. Non-taxation of benefits from a public compensation plan for occupational accidents	173 917	181
22. Non-taxation of benefits from a public compensation plan for traffic accidents	30 384	50
23. Benefits from a public compensation plan for crime victims	4 792	5
24. Non-taxation of certain income from indemnities related to physical or mental injury	n/a	n/a
25. Non-taxation of social assistance payments	n/a	n/a
26. Non-taxation of certain pensions and indemnities paid to RCMP officers	n/a	n/a
27. Non-taxation of income support benefits, pensions, allowances or war indemnities paid to veterans and civilians	n/a	23

TABLE 14

Measures that must remain unchanged – Personal income tax (continued)

Measure	Number of applicants in 2011[1]	Cost in 2013 (in millions of $)
28. Non-taxation of certain indemnities paid to military personnel and veterans	n/a	7
29. Non-taxation of financial assistance pertaining to childcare expenses received under governmental employment assistance programs	n/a	n/a
30. Non-taxation of strike benefits	n/a	n/a
31. Taxation of capital gains at the time of realization	n/a	n/a
32. $1 000 exemption of capital gains realized at the time of sale of property for personal use	n/a	n/a
33. $200 exemption on capital gains realized on foreign exchange	n/a	n/a
34. Registered retirement savings plan	n/a	n/a
35. Registered disability savings plan	n/a	f
36. Non-taxation of investment income from a tax-free savings account	n/a	78
37. Deferral of the taxation of wages	n/a	n/a
38. Deferral attributable to the 10-year reserve for capital gains at the time of sale to children of the shares of a corporation that operates a small enterprise	983	16
39. Deduction for flow-through shares	n/a	4
40. Family trusts	n/a	n/a
41. Non-taxation of gifts and bequests	n/a	n/a
42. Non-taxation of winnings from lotteries or gambling	n/a	392
43. Exemption from making quarterly remittances	n/a	n/a
44. Capital gains deferral		
– Farm property or fishing property transferred to children	n/a	n/a
– 10-year reserve for capital gains at the time of sale to children of farm property or fishing property	n/a	7
45. Farm loss carry-overs of part-time farmers	17 687	10
46. Capital gains deferral through a transfer between spouses	n/a	n/a
47. Capital gains deferral by means of the five-year reserve	1 085	10
48. Reduction in the capital gains inclusion rate stemming from a gift of property with undeniable ecological value	n/a	n/a
49. Non-taxation of gains related to gifts and other transfers of cultural property	n/a	n/a
50. Non-taxation of gains related to gifts of musical instruments	n/a	n/a
51. Additional tax credit of 25% for an initial large cultural donation	n/a	f
52. Tax credit for cultural patronage	n/a	f
53. Tax credit for union and professional dues	1 788 109	239
54. Tax credit for dues paid to artistic associations	n/a	f
55. Refundable tax credit for informal caregivers of adult persons	47 760	54
56. Child alimony and maintenance allowance	n/a	18

TABLE 14

Measures that must remain unchanged – Personal income tax (continued)

Measure	Number of applicants in 2011[1]	Cost in 2013 (in millions of $)
57. Tax credit respecting the essential needs of persons living alone	973 367	102
58. Medical expense tax credit	2 034 405	674
59. Refundable medical expense tax credit	214 278	50
60. Non-refundable tax credit for medical care not provided in the region of residence	11 583	f
61. Non-inclusion of the Universal Child Care Benefit in the calculation of tax credits determined according to income	n/a	32
62. Refundable tax credit for the supplement for children with disabilities	33 443	82
63. Work premium adapted to individuals with severely limited capacity for employment	8 848	6
64. Supplement for long-term beneficiaries leaving last-resort financial assistance or the Youth Alternative Program	4 775	5
65. Deferral of the taxation of an eligible dividend	1 365	f
66. Tax credit for infertility treatments	2 552	3
67. Cooperative Investment Plan	n/a	11
68. LogiRénov tax credit	n/a	n/a
TOTAL		**4 199**

f: The fiscal cost is less than $2 million.
n/a: The number of applicants or the financial impact is unavailable because of insufficient or missing data.
(1) The number of applicants does not necessarily correspond to the number of taxpayers who have benefited from the tax expenditure or who are affected by the proposed change. By way of an example, a non-taxpayer does not fully benefit from the measures that he requests. What is more, refundable tax credits may be claimed by one or two taxpayers in a household.

❑ Measures examined in the section on corporate tax

Certain fiscal measures respecting personal income tax also apply to corporate income tax. To broaden understanding, the measures are analyzed once in the section devoted to corporate income tax.[21]

Specifically, the measures focus on:

— refundable tax credit for taxi drivers and taxi owners;

— additional deduction of 100% in the calculation of the income of the employer of the amount repaid to an employee to purchase an eligible mass transit fare or an eligible paratransit fare;

— refundable tax credit for the reporting of tips;

— refundable research and development tax credits;

— deduction for entertainment expenses;

— capital cost allowance (surplus in relation to booked depreciation)

— capital gains deferral by means of rollover provisions;

— deferral by means of billing-based accounting for certain professionals;

— deduction of eligible losses in respect of an investment in a business;

— capital gains deferral;

— loss carry-overs other than capital losses;

— deferral of farm and fishing losses;

— preferential tax treatment accorded the agricultural sector or the fishing sector with regard to:

  — the possibility of using cash-based accounting;

  — flexibility in counting of inventories on hand;

— deduction of contributions paid to an environmental trust;

— property tax refund for forest producers;

— deduction for logging tax;

— refundable tax credit for traineeships in the workplace.

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[21] For additional information, see the Part 2 of this report.

TABLE 15

Tax measures respecting personal income tax examined in the section devoted to corporate tax that must be abolished or modified

Measure	Number of beneficiaries in 20111	Financial impact for the government (millions of dollars)
Measures to be abolished		
1. Refundable tax credit for taxi drivers and taxi owners	7 699	4
2. Additional deduction of 100% in the calculation of the income of the employer of the amount repaid to an employee to purchase an eligible mass transit fare or an eligible paratransit fare	n/a	—
Measures to be modified		
3. Refundable tax credit for the reporting of tips	843	—
TOTAL		**4**

n/a: The number or cost is unavailable because of insufficient or missing data.

TABLE 16

Tax measures respecting personal income tax examined in the section devoted to corporate tax that must remain unchanged

Measure	Number of beneficiaries in 2011	Cost[1] (millions of dollars)
1. Refundable research and development tax credits	13	f
2. Deduction for entertainment expenses	195 678	21
3. Capital cost allowance (surplus in relation to booked depreciation)	n/a	n/a
4. Capital gains deferral by means of rollover provisions	n/a	n/a
5. Deferral by means of billing-based accounting for certain professionals	n/a	n/a
6. Deduction of eligible losses in respect of an investment in a business	2 758	10
7. Capital losses	110 278	37
8. Loss carry-overs other than capital losses	10 846	19
9. Farm and fishing losses	1 832	2
10. Preferential tax treatment accorded the agricultural sector or the fishing sector with regard to:		
– Possibility of using cash-based accounting	n/a	n/a
– Flexibility in counting of inventories on hand	n/a	n/a
11. Deduction of contributions paid to an environmental trust	8	f
12. Property tax refund for forest producers	6 796	5
13. Deduction for logging tax	152	f
14. Refundable tax credit for traineeships in the workplace	n/a	f
TOTAL		**94**

f: The fiscal cost is less than $2 million.
n/a: The number or cost is unavailable because of insufficient or missing data.
(1) Estimate for 2013.

6.2 Measures concerning certain specific tax expenditures

Certain specific tax measures pertaining to more complex fiscal concepts or that require fuller explanations are presented in detail below:

— revision of income recognized in the calculation of socio-fiscal credits;

— revision of capital gains taxation;

— tax assistance granted to tax-advantaged funds;

— the Stock Savings Plan;

— the use of the RRSP and the TFSA.

❑ Revision of income recognized in the calculation of socio-fiscal credits

There is a disparity between the treatment of income with regard to the calculation of socio-fiscal credits. Certain income is recognized while other income is excluded.

The committee recommends that, generally speaking, all income be considered in the income used to calculate eligibility for the socio-fiscal credits, whether or not such income is taxable. A limited number of exceptions may be justifiable in specific instances but it is essential to explain the reasons for them.

At present, payments deemed to be non-taxable are sometimes included in the computation of income used to determine the amount of the solidarity tax credit to which the taxpayer is entitled, while other amounts that are also non-taxable are excluded.

— For example, payments received pursuant to last-resort financial assistance and benefits from a public compensation plan are recognized in the calculation of the credit.

— On the other hand, strike benefits are excluded from the calculation.

❑ Revision of capital gains taxation

The committee recommends a comprehensive revision of capital gains taxation. The revision would seek to treat more fairly capital gains compared with other sources of income.

The recommended revision would require Canada-wide coordination to avoid capital gains realization simply shifting outside Québec were Québec to act alone.

The revision would not be applied retroactively, i.e. it would not apply to capital gains prior to the implementation of the recommended reform.

■ Modify the existing regime

Under the existing regime, the treatment of capital gains is an integral part of both personal income tax and corporate income tax.

In Québec as in Canada as a whole, such treatment is subject to specific rules more favourable than the general regime, which means that they are deemed to be tax expenditures.[22]

Four tax expenditures thus concern capital gains taxation or are linked to it:

— partial inclusion of capital gains, which defines the specific tax treatment from which income of this nature benefits both for individuals and for corporations;

— non-taxation of the capital gain on principal residences;

— lifetime capital gains exemption;

— preferential treatment accorded stock options granted to employees.

The cost of the tax measures is substantial.

In 2013, the partial inclusion for individuals of capital gains represented a tax expenditure of nearly $740 million. Again in 2013, the non-taxation of the capital gain on principal residences engendered a tax expenditure of nearly $1.2 billion. The same year, the lifetime capital gains exemption for farm or fishing property and the sale of a business cost $156 million. At the same time, the tax treatment accorded stock options represented a tax expenditure of $45 million.

All told, the tax expenditures stemming from the treatment for individuals of capital gains stood at nearly $2.1 billion.

The changes that the committee is proposing cover the four tax expenditures pinpointed.

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[22] For additional information, see Part 5 of Volume 3 of this report.

■ The partial inclusion of capital gains

The revision that the committee is proposing is substantial. It would more fairly treat capital gains in relation to other sources of income and explicitly take into account inflation.

▪ The existing regime

At present, capital gains are partly taxed. Only half of the capital gain is considered in the determination of taxable income. This partial inclusion "seeks to recognize that the appreciation in the value of a property does not necessarily correspond to enrichment for the taxpayer, bearing in mind inflation."[23]

The inclusion rate has often varied over time and is not linked to inflation. To a large extent, the rate seems arbitrary. It is especially hard to justify such a rate to offset inflation for property owned over a short period.

In 1962, the Royal Commission on Taxation recommended to the federal government that it tax all capital gains.[24] The committee is proposing that Québec apply this basic principle explicitly bearing in mind inflation, the reason invoked to only partially include capital gains.

▪ The proposed revision

The committee recommends the elimination of the partial inclusion of capital gains and its replacement by the recognition of the real capital gain, i.e. the capital gain that takes into account inflation. The capital gain would thus be taxed normally, like any other income.

The capital gains inclusion rate should be directly linked to inflation that affects the purchasing power of the gain effected.

— In the case of capital gains realized at the time of disposition of property owned for less than one year, the capital gain must be taxed like any other income.

— Beyond the one-year time limit, the capital gain realized would be adjusted to take into account inflation. For a period of possession exceeding one year, the taxation would decrease according to the number of years of ownership of the property before its sale and the inflation rate applicable during that time.

The measure would not be retroactive, i.e. it would not apply to capital gains prior to its implementation.

As is now the case, the capital gain should only be recognized when it is effective. The committee believes that annual recognition of the capital gain is inapplicable because of the administrative red tape that doing so would engender, and compliance costs.

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[23] Ministère des Finances du Québec, *Dépenses fiscales – Édition 2013*, March 2014.

[24] *Report of the Royal Commission on Taxation*, 1966.

- ***Necessary harmonization***

The Commission on Taxation and the Financing of Public Services noted in 1996 that a higher rate in Québec would lead taxpayers to realize their capital gains outside Québec and we would lose a portion of the tax yield from this measure.[25]

It is not so much that the adoption of this measure raises harmonization problems: the inclusion rules concerning capital gains could very well differ between the federal government and Québec. It is instead a question of competitiveness as such a measure must thus be coordinated with the other Canadian provinces.

For this reason, Québec should initiate discussions for this purpose with the other provinces and the federal government. In the absence of such coordination, the measure could lead to undesirable behaviour among taxpayers because of a reduction in the anticipated yields and a loss of competitiveness in the Québec taxation system.

The treatment of the capital gain in other jurisdictions

In 2013, the OECD produced a study that clearly describes the treatment of the capital gain in numerous jurisdictions.[1]

It reveals that a number of jurisdictions take into account the holding period of property to determine the inclusion rate of the capital gain. The holding period varies considerably from one country to the next.

Without listing all of the countries, Germany, Australia, Belgium, the United States and Finland apply specific treatment depending on the holding period.

The study also reveals that certain jurisdictions, such as Chile, Spain, Portugal and Mexico, take into account inflation in order to determine the taxable portion of the capital gain.

1 Michelle Harding, "Taxation of Dividend, Interest and Capital Gain Income in *OECD Taxation Working Papers*, N°. 19, 2013.

25 *Working Together for a Responsible Quebec: Report of the Commission on Taxation and the Financing of Public Services*, October 1996.

■ Non-taxation of the capital gain on principal residences

The committee is not calling into question the principle of the non-taxation of the capital gain on a principal residence. Such an exemption is warranted but its application must be regulated.

▪ The current regime

At present, under certain conditions, the capital gain realized by an individual on the sale of a principal residence is not taxable. No limit is set on the size of the gain that may thus be realized nor on the number of transactions that may be carried out.

It should be noted that, depending on their respective tax expenditures, the Québec and federal governments justify this tax benefit differently.

— The Québec government believes that the non-taxation of the capital gain on principal residences promotes home ownership and the constitution of a family patrimony by exempting from tax the return on this important form of saving.

— For the federal government, the measure instead takes into account that principal residences are usually purchased to provide basic housing and not for investment purposes. Moreover, the exemption adds flexibility to the housing market by facilitating changes of principal residence in light of changing life situations.

▪ The proposed revision

The committee nonetheless wishes to restrict the application of the non-taxation of the capital gain on principal residences by excluding gains stemming from speculation and by taxing a portion of non-recurring gains.

To this end, the committee is proposing to:

— tighten the rules in order to detect cases of speculation, in particular through an explicit definition of the very concept of speculation;

— limit the non-taxation of an indexed lifetime capital gain of $1 million.

The rules would only apply to capital gains actually realized, i.e. on the capital gains obtained at the time of sale of the principal residence.

Since the principle of the non-taxation of the capital gain on principal residences would remain, there is no reason to make mortgage interest deductible.

This change would not be retroactive, in the same way as revision of the partial inclusion.

■ The lifetime capital gains exemption

The revision that the committee is advocating includes a proposal aimed at converting the existing lifetime capital gains exemption into an additional RRSP contribution.

In the short term, the committee has pinpointed several solutions to facilitate the transfer of businesses between persons dealing on a non-arm's length basis by proposing the amendment of the existing rules governing the non-eligibility for exemption of capital gains.

▪ The current regime

In 2014, under the Québec and federal taxation systems, the capital gain realized through the sale of shares in a company could benefit from an $800 000 lifetime capital gain exemption, under certain conditions. In December 2014, the Québec government raised the exemption to $1 million for farm property or fishing property. It remains at $800 000 under the Canadian taxation system.[26]

The exemption is intended to recognize that for a farmer, a fisherman or the owner of an SME, the value of his enterprise constitutes the capital that will enable him to finance his retirement.

The exemption does not apply when certain transfers occur of the business between its owner and a corporation dealing on a non-arm's length basis with the vendor.

▪ The proposed revision

Certain authors[27] maintain that the capital gains exemption is not an effective way to foster investment and risk-taking.

The committee is of the opinion that the lifetime capital gains exemption is not an appropriate way to encourage personal savings for retirement. The exemption is often used for purposes other than preparation for retirement. Tax planning schemes, in particular by means of trusts, are set up to multiply the use of this exemption in a family or a group of persons dealing on a non-arm's length basis.

The committee recommends that the existing lifetime capital gains exemption be replaced by an additional RRSP contribution in order to directly foster saving for retirement. The government would thus better respond to the exemption's rationale, i.e. the preparation for retirement of the vendor.

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[26] For years subsequent to 2014, the exemption will be indexed for inflation.

[27] Jack M. Mintz and Stephen R. Richardson, "The lifetime capital gains exemption: an evaluation," University of Toronto and Department of Finance Canada, 1995.

- ***The proposed rules***

Accordingly, at the time of sale of the shares of a corporation, a farm property or a fishing property, the vendor could tax himself on the gain or contribute to his RRSP or to a registered retirement income fund (RRIF) an amount equivalent to the maximum annual RRSP contribution multiplied by the number of years that he has held the enterprise.

The gains stemming from the sale would not be taxable on the earnings transferred to the RRSP. This contribution would not, therefore, entitle the individual to an additional deduction since the amount transferred is not taxable. What is more, the contribution would not affect the accumulated contribution room.

The lifetime maximum amount to be contributed should be $400 000, indexed for inflation, if we want to offer at the time of sale the same tax benefit as the existing $800 000 exemption at the 50% inclusion rate. The amount should be $500 000, indexed for inflation, in the case of farm property or fishing property, to take into account the new exemption ceiling that the Québec government defined in December 2014.

Québec could not implement on its own this recommendation. Its application would require an agreement with the federal government.

The application of this recommendation would not engender any additional cost but ultimately a saving for the government: the taxation of the gain would be carried forward over time instead of being non-existent.

It must be emphasized that the replacement of the lifetime capital gains exemption by an additional RRSP contribution would have a positive impact by halting certain planning schemes that hinge on the multiplication of the use of the capital gains exemption.

- ***A recommendation already formulated in the past***

Moreover, this recommendation has already been formulated in the past.

The *Report of the Technical Committee on Business Taxation* published in 1997 by the Department of Finance Canada[28] proposed:

— the elimination of the lifetime capital gains exemption on farm property and the qualifying shares of corporations operating a small enterprise;

— the replacement of the exemption by an enhanced RRSP contribution system that would enable taxpayers to use taxable capital gains on farm property and the qualifying shares of small enterprises to increase their contribution room to the RRSP in previous years.

In Québec, a recommendation along the same lines appeared in the report of the Commission on Taxation and the Financing of Public Services published in 1996.[29]

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[28] Technical Committee on Business Taxation, *Report of the Technical Committee on Business Taxation*, Department of Finance Canada, 1997, pages 7-20.

[29] Commission on Taxation and the Financing of Public Services, *Working Together for a Responsible Quebec: Report of the Commission on Taxation and the Financing of Public Services*, Gouvernement du Québec, 1996, page 84.

- **A short-term solution to facilitate business transfers between persons dealing on a non-arm's length basis**

- ***The current problem***

Transfers of businesses between persons dealing on a non-arm's length basis clash with a fiscal obstacle that is directly affecting the new generation of owners of SMEs. The problem stems from the failure to apply the exemption when certain transfers occur of the business between its owner and a corporation with a non-arm's length relationship with the vendor, e.g. between a parent and his child.

A parent may directly sell the shares of his enterprise to his child and be eligible for the exemption. However, the child must personally finance the acquisition from his own funds or loans.

On the other hand, a parent may not sell the shares of his enterprise and be eligible for the exemption if the sale is made to a corporation with which the parent has a non-arm's-length relationship. It may be advantageous to use a corporation to purchase the shares in order to finance the purchase by means of the corporation's capital. For the parent, the amount of the sale is treated as a dividend instead of a capital gain.

The definition of the non-arm's-length relationship is broadened in respect of this type of transaction.[30]

However, a sale of this nature is eligible for the exemption if it is made by a corporation at arm's length.

- ***The ineligibility of the lifetime capital gains exemption***

Ineligibility for the lifetime capital gains exemption between taxpayers dealing on a non-arm's length basis is attributable to the need to avoid certain abuses. In the case of family businesses, it would be easy to transfer the shares and thus change ownership, thereby allowing taxable dividends to be transformed into exempted capital gains.

The question of the tax treatment of transfers of businesses between persons dealing on a non-arm's length basis therefore stems directly from the existence of the capital gains exemption, under certain conditions.

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30 Section 84.1 of the federal *Income Tax Act* and section 517 of the Québec *Taxation Act* describe more precisely the notion of the non-arm's-length relationship.

- ***An irritant***

Such ineligibility is a frequently denounced irritant.[31] Current tax rules favour the sale of businesses to purchasers with whom the vendors have an arm's length relationship, which can affect family business successions.

Ineligibility for the lifetime capital gains exemption of non-arm's length sales of shares penalizes the transfer of property within a family. It makes them less fiscally advantageous for the vendor than transfers of an arm's length person with the risk that implies for the company's survival and its continued presence in the community.

- ***The committee's analysis***

The committee has analyzed this problem in order to facilitate transfers of the ownership of businesses between generations in a given family.

The problem would vanish if the lifetime capital gains exemption were replaced by an additional RRSP contribution, as the committee is proposing.

- ***Three conceivable solutions***

Given the impossibility of calling into question in the short term the exemption itself and to stimulate investments by facilitating business transfers between persons dealing on a non-arm's length basis, the committee has identified three solutions that it recommends the government contemplate. In all of the solutions identified, the committee is insisting on the importance of defining the specific tax rules for transactions genuinely related to family business successions.

The **first solution** would consist in reaching agreement with the federal government such that the sale of a businesses by parents to their children through a corporation be eligible for the capital gains exemption under certain specific conditions.

This would ensure that the sale by parents to their children is indeed a transaction that transfers ownership of the business and that the children participate actively in it.

The examination of the transaction could centre on the existing "advance income tax ruling" process whereby Revenu Québec analyzes the transaction before it is carried out and confirms its eligibility or ineligibility. If the transaction is compliant, the sale of the shares would be treated as a capital gain for the vendor without the current restrictions that impose treatment in the form of a dividend.

This solution would make fully neutral the sale of a business depending on whether it is conducted through the intermediary of a corporation to the children or to a taxpayer dealing at arm's length with the vendor.

Such a solution would require an agreement with the federal government.

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[31] In particular, tax experts from Raymond Chabot Grant Thornton, an accounting firm, have already raised the question of transfers of family businesses and proposed solutions to facilitate such transfers. The authors particularly mentioned the complexity of business transfers. Given that the problem raised addressed both the federal government and the Québec government. See www.rcgt.com/en/news/business-transfers-report/.

Under the **second solution**, Québec would intervene independently of the federal government and would remedy the situation solely in respect of Québec tax, under specific conditions.

Québec could qualify the transaction as a "commercial" one once it applied a verification mechanism similar to the existing advance income tax ruling process under the Québec tax regime.

Québec would thus offer a tax credit to offset the difference between the tax paid in cases where the business was sold to the children through a corporation and the tax that would have been payable in the case of a sale to a person dealing at arm's length. However, the sale to a taxpayer dealing at arm's length would continue to be advantageous because of federal taxation.

This is only a partial solution that does not compensate the difference in treatment under the Québec taxation system.

This solution also implies a significant administrative burden for the processing of files and follow-up over time. For example, a minimum holding time should be imposed after the sale as a condition to be abided by or a minimum transfer as a percentage of the shares should be contemplated.

The **third solution** would be of another order and would consist for Québec in according all businesses the treatment now allowed agricultural enterprises or fishing businesses. Its application beyond agricultural enterprises or fishing businesses would require consultation with the federal government.

In the case of such entreprises, a parent may sell directly to his child his shares at a fiscal cost below the fair market value of the business. The selling price for the vendor becomes the acquisition cost for the child.

The purpose of this provision is to facilitate the financing of the transaction for the child making the purchase, who is not necessarily paying the fair market value of the shares. Its application beyond agricultural enterprises or fishing businesses would require consultation with the federal government.

This solution would facilitate the renewed ownership of the business by a child but would not allow the parent selling the business to benefit fully from all of the potential capital gains and the attendant exemption.

- ***Administrative penalties imposed on third parties***

It would be important to make provision for rules governing administrative penalties imposed on third parties. Such rules would essentially seek to dissuade individuals who advise others to file false or misleading income tax returns in order to ensure compliance with the law.

- ***The additional cost for the Québec government***

To extend the capital gains exemption realized through the sale to a child of a business would engender an additional annual cost of roughly $100 million for the Québec government. The additional cost should be assumed both in respect of the first solution and the second one. The cost could increase significantly in the coming years since the pool of businesses likely to be sold will grow.

The committee is of the opinion that the enhancement of the amount eligible for capital gains exemption for farm property or fishing property that the government announced in December 2014 does not solve the problem of business succession. In this situation, it would be preferable to allocate the funds intended to enhance the eligible amount to the solution aimed at ensuring eligibility for the capital gains exemption realized by the sale of a business to the owner's child.

- **The case of farm property**

Ineligibility for the lifetime capital gains exemption between taxpayers dealing on a non-arm's length basis led the committee to analyze a problem related to farm property.

The capital gains exemption for the sale of an enterprise also applies to the sale of agricultural land. If the property has been transferred from one generation to another and even it has already changed use, perhaps for decades, it is usually sufficient for the property to have already been used for agricultural purposes to maintain its eligibility for exemption.

Accordingly, the committee recommends terminating the eligibility of farm property when it is no longer used for agricultural purposes.

■ The preferential treatment accorded stock options granted to employees

The stock options awarded to employees were implemented to encourage top-tier executives to remain in their positions. In large businesses, the stock options seek to interest senior executives in the company's results since the value of the shares is readily quantifiable on the market.

Stock options do not play the same role in small enterprises or in firms not listed on the stock market. They are difficult to convert into cash and are not, therefore, directly part of the employees' remuneration.

▪ Existing tax provisions

Favourable tax provisions have been adopted to treat the taxable benefit that the value of the shares represents once the option has been exercised, i.e. the difference between the value of the share and the amount that the purchaser actually paid for it.

▪ *The federal government*

In the case of the federal government, the provisions concerning stock options are modeled on the tax rules applicable to capital gains.

▪ *Québec*

Between 1991 and 2002, Québec applied the same treatment to stock options as under the federal and the other provincial regimes. Since 2003, the rate of the deduction for stock options has been reduced to 25%[32] instead of 50% as is the case in the rest of Canada.

The principle invoked to justify the tax change was that we must ensure some degree of fairness with the tax treatment of employees' wages, since such wages are fully taxed. On the other hand, the inclusion rate of the capital gain is still 50%, as it is under the federal regime.

In 2008, Québec implemented a new measure. The deduction rate of stock options was once again set at 50%, in keeping with the treatment of the capital gain, solely in the case of innovative businesses with assets of less than $50 million and that are entitled to tax credits for scientific research and experimental development during the current year or the three previous years.

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[32] The rate was first reduced from 50% to 37.5% in 2003, then from 37.5% to 25% in 2004.

- **The recommendation of the Task Force on the Protection of Québec Businesses**

One of the recommendations of the Task Force on the Protection of Québec Businesses, established on June 7, 2013 by the Minister of Finance, was to "[g]rant tax treatment of the gains on share call options that is more favourable than elsewhere in Canada to maximize the development of head offices and the attraction and retention of senior executives to Québec or at least harmonize such tax treatment with the other Canadian provinces."[33]

The Task Force on the Protection of Québec Businesses had a mandate to recommend measures to protect Québec firms from unwanted takeover bids and to promote the maintenance and development of head offices in Québec.

- **Abolish preferential treatment**

The reduction of the taxable benefit related to the acquisition of stock options is more or less modeled on capital gains taxation. Since it has been proposed in the medium term to abolish the partial inclusion of capital gains, it would be logical to also abolish the preferential treatment accorded stock options.

The committee recommends that Québec take steps with the other provinces such that the preferential treatment accorded stock options granted to employees be abolished in all of the provinces. Indeed, it would be desirable to abolish such preferential treatment, which requires the coordination of all of the provincial partners.

This coordination should be carried out within the framework of a broad discussion of the treatment of the capital gain overall, the results of which can only be anticipated in the medium term.

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[33] Task Force on the Protection of Québec Businesses, *The Maintenance and Development of Head Offices in Québec* [report], Québec, February 2014, page 46.

- **A solution in anticipation of the abolition of preferential treatment**

However, the committee has noted, as is the case in the treatment of the capital gain in general, that it is undesirable to maintain in Québec treatment that differs from what prevails in the other provinces.

The committee has been made aware that the restrictive treatment that Québec accords risks encouraging the beneficiaries of the measures to move outside Québec.

To attain its objective from a fiscal standpoint, such a move must mean that the individuals concerned cease to be Québec residents by establishing their place of residence in another province. In such a case, Québec would lose not only the tax related to the stock options but all of the income tax payable by such taxpayers.

The committee has also noted that the treatment of stock options cannot be the same for large businesses operating as public business corporations and small enterprises incorporated as private corporations.

Until all of the provinces abolish the preferential treatment accorded the stock options granted to employees, the committee has formulated the following recommendation.

In the case of public business corporations, the committee recognizes that the tax treatment of stock options is at the very root of the reasons that led to their implementation. In the current context, the committee recommends that Québec harmonize its provisions with those elsewhere in Canada to avoid having its high-income earners move to the other provinces.

As for private corporations, the committee recommends the maintenance of the current treatment:

— the application of a 25% deduction rate for small enterprises incorporated in the form of private corporations;

— the application of a 50% deduction rate for certain businesses with assets of less than $50 million and that are entitled to tax credits for scientific research and experimental development during the current year or the three previous years.

In the latter instance, the measure is warranted since the areas of activity are riskier.

❑ Revision of the assistance accorded tax-advantaged funds

The committee examined tax-advantaged funds given the role that they play in Québec in the capitalization of businesses and the scope of the attendant tax expenditures.

The funds were created to support Québec SMEs by means of non-guaranteed venture capital. They also seek to create or maintain jobs, promote economic growth and enhance productivity and innovation.

Tax-advantaged funds are also intended to promote saving for retirement and to engage in job economic training.

■ Québec has three tax-advantaged funds

The first and biggest fund is the Fonds de solidarité (FTQ), established in 1983. As at May 31, 2014, its net assets stood at $10.1 billion. It invests in 25 areas of activity including, in particular, the aerospace, agri-food and clean technologies industries.

The Fondaction de la CSN was created in 1995. As at May 31, 2014, its net assets stood at $1.2 billion. It specializes in the social economy and sustainable development sectors and also invests in businesses engaged in a participative management process.

The Fonds Capital régional et coopératif Desjardins was established in 2001 within the framework of the economic development strategy for Québec's resource regions. As at December 31, 2013, the fund held net assets of $1.5 billion. At the outset, the fund concentrated its investments in the technological and innovative sectors. Since 2005, it has refocused on more traditional sectors.

Together, the net assets of the two labour-sponsored funds and the Fonds Capital régional et coopératif Desjardins total nearly $13 billion. The three funds invest more than $800 million annually in Québec firms.

■ Existing measures

The funds benefit from significant tax measures to support subscription of their capital. The Québec government offers a non-refundable tax credit applicable to the acquisition cost of the funds' shares. The acquisition cost is eligible for the deduction for an RRSP contribution in the case of the two labour-sponsored funds but ineligible as regards the Fonds Capital régional et coopératif Desjardins.

The rates of the tax credits are:

— 15% for the Fonds de solidarité FTQ;

— 25% for Fondaction until May 31, 2015, then 15% thereafter;

— 45% for the Fonds Capital régional et coopératif Desjardins.

The two labour-sponsored funds also benefit from a federal tax credit set at 15% in 2014. The rate will fall to 10% in 2015, 5% in 2016 and be eliminated starting in 2017.

■ The limits imposed

The subscription limit is $5 000 per shareholder. The shares must be held until retirement in the case of the labour-sponsored funds and for a minimum of seven years as regards the Fonds Capital régional et coopératif Desjardins.

The two labour-sponsored funds are not subject to any ceiling in respect of capitalization. The maximum capitalization of the Fonds Capital régional et coopératif Desjardins is set at $1.25 billion. It has attained the limit.

For the 2014-2015 fiscal year, the two labour-sponsored funds had to observe an issuance ceiling of $650 million in the case of the Fonds de solidarité FTQ, and $200 million in the case of Fondaction. The shares that the Fonds Capital régional et coopératif Desjardins issues may not exceed $150 million per year.

■ A role essential to finance the investments of SMEs

The three funds must comply with investment standards and the rules governing the businesses that may benefit from their support.

They play a pivotal role in financing the investments of SMEs. In June 2014, the funds had 840 000 shareholders and were partners with nearly 3 000 businesses.

■ Recommendations

The committee has formulated four recommendations concerning tax-advantaged funds.

The recommendations concerning the labour-sponsored funds would not have any financial impact for the government. Those pertaining to the Fonds Capital régional et coopératif Desjardins would enable the government to save $30.0 million in 2015-2016 and $7.5 million annually in the long run.

▪ Redefine the tax credit rates

The committee has formulated an initial series of recommendations concerning the tax assistance that the funds receive aimed at redefining the tax credit rates. The committee recommends that:

— the tax credit rate applicable to the purchase of shares in each of the two labour-sponsored funds be standardized at 15% as of May 31, 2015 as planned;

— the tax credit rate applicable to the purchase of shares in the Fonds Capital régional et coopératif Desjardins be reduced from 45% to 25%.

The reduction would enable shareholders of the Fonds Capital régional et coopératif Desjardins to obtain a tax yield comparable to that obtained by the shareholders of the two labour-sponsored funds when account is taken of the eligibility for an RRSP of labour-sponsored fund shares.

The committee is also formulating certain modifications to the funds' operation to broaden their contribution to Québec's economic development.

▪ Broaden the investment standard

The committee first recommends that the minimal proportion of eligible investments that the three tax-advantaged funds must make in Québec SMEs—the "investment standard"—be raised from 60% to 65 %.

To give the funds the means to abide by the new standard, no ceiling on annual issues would be imposed on the labour-sponsored funds. In the case of the Fond Capital régional et coopératif Desjardins, the total capitalization ceiling of $1.25 billion would be abolished and the fund could issue $150 million annually.

The investment standard now stands at 60%, which means that 60% of the portfolio of the tax-advantaged funds must comprise eligible investments, in particular investments in Québec SMEs.

This share for the three funds would increase from 60% to 65% in 2016-2017 and would be maintained at that level for five years. Starting in 2020-2021, the share would be increased annually by 1 percentage point such that it reaches 70% in 2024-2025. In the case of the Fonds Capital régional et coopératif Desjardins, the regional component of the investment standard would not change. The investment standard now stands at 35%.

▪ Increase the minimum holding period

To afford the three tax-advantaged funds greater leeway in their investment decisions, the committee recommends that the government increase the minimum holding period for shares.

The holding period for the two labour-sponsored funds would be increased from two years to five years. In the case of the Fonds Capital régional et coopératif Desjardins, the obligatory holding period for shares would be increased from seven years to 10 years.

❑ The Stock Savings Plan

The Stock Savings Plan II (SSP II) and the tax credit for flotation costs ended on December 31, 2014.

The SSP II was established in 2005 to promote public financing of small Québec firms. It was enhanced in 2009 and a tax credit for flotation costs for an initial public offering was implemented in 2012.

■ Measures that did not achieve the anticipated success

It should be noted that since their inception, the SSP II and the tax credit for flotation costs have not yet met expectations.

Indeed, since 2005, 33 share issues have been carried out, only three of them since 2011. Individuals who benefit from the program invest solely in qualified investment funds rather than in eligible corporations. The two funds that comply with the plan's eligibility requirements are:

— the Fonds Cote 100 REA II;

— The Fiera Capital QSSP II Investment Fund.

Since 2005, two funds have raised just over $16 million annually.

An array of reasons explain why the share of Québec firms in the Canadian market for initial public offerings is smaller than their economic weight, such as the direct costs of public offerings, recurring costs to maintain that status of the corporation listed on the stock market, the centralization of the financial sector in Toronto and the language problem, and complex, costly regulations that are scarcely adapted to SMEs.

It should also be noted that the supply of capital is abundant in Québec, which enables entrepreneurs to finance their projects by means other than initial public offerings.

■ Measures that should not be renewed

For all of these reasons, the committee has concluded that the government should neither revive the SSP II nor the tax credit for flotation costs applied to corporations.

❑ Use of the RRSP and the TFSA

The RRSP is, overall, a sound retirement savings measure. At present, the funds deposited in an RRSP may be withdrawn at any time, regardless of age and are simply taxable at the time of withdrawal.

■ Assess a penalty on certain RRSP withdrawals

The possibility of withdrawing funds without penalty may undermine preparation for retirement. In cases where individuals withdraw funds to cope with difficult circumstances, premature withdrawals may be warranted. On the other hand, under other circumstances, premature withdrawals may lead to poor financial planning.

While individuals appear to take into account the costs and benefits of their short-, medium- and long-term actions, in point of fact they often tend to overestimate the consequences of their short-term gestures. Recent research in the realm of behavioural economics offers proof in this respect.[34]

Against this background, mechanisms that create for savers incentives to abide by their commitments and intentions in relation to their financial planning for retirement could enhance decision-making. Recent empirical studies on the topic tend to reveal that such mechanisms do not discourage saving. The opposite appears to be true.

To ensure that funds saved in an RRSP are used, first and foremost, for retirement, the committee recommends that a penalty of up to 10% be levied when funds are withdrawn from an RRSP before the age of 55, except under certain specific circumstances.

▪ Exceptions to the penalty

Certain exceptions should apply to the proposed penalty to take into account events that may arise during an individual's lifetime that lead to serious financial difficulties. This is true, for example, of a severe or prolonged disability that leads to permanent unemployability, death, serious, irreversible illness, or a disaster involving the principal residence. What is more, such circumstances are recognized in the provisions governing procedures for withdrawing funds invested in tax-advantaged funds such as the Fonds de solidarité de la FTQ.

The withdrawals allowed under the Home Buyers' Plan and the Lifelong Learning Plan would continue to apply under the same conditions. The penalty should be paid when the funds are withdrawn, at the same time as the deduction at source already stipulated in such cases.

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[34] See, in particular, John Beshears *et al.*, *Self-Control and Liquidity: How to Design a Commitment Contract*, NBER discussion, September 20, 2011, and John Beshears *et al.*, *Optimal Illiquidity in the Retirement Savings System*, report prepared for the 16th annual conference of the Retirement Research Consortium, 2014.

- **Deductions at source**

Withdrawals from RRSPs are subject to tax deductions at source and the deduction rates applied depend on the amount of the withdrawal requested.

Withdrawals of $5 000 or less are subject to a 10% rate for federal income tax, which rises to 20% for amounts ranging from $5 000 to $15 000, and to 30% for any amount greater than $15 000. To the federal deduction rate is added the Québec rate of 16%, corresponding to the lowest rate on the tax rate schedule. The rate applies irrespective of the amount of the withdrawals.

The committee also recommends that the deduction at source be changed to the maximum tax rate for any withdrawal before the age of 55 in order to discourage such withdrawals. Québec could implement such a measure without harmonization with the federal government.

- **Initiate a Canada-wide discussion on the coherence of tax tools that encourage saving**

Aside from the registered pension plans of employers, the RRSP and the TFSA are the main fiscal vehicles to encourage saving. Both savings vehicles operate in a parallel manner with two distinct incentives:

— the RRSP, examined earlier, is a tax deferral system;

— the TFSA is a zero-rating system for returns since it allows the payment of non-deductible funds into an account in which investment income and withdrawals are entirely tax free.

Since 2009, the contribution room to the TFSA has stood at $5 000 per year, indexed in $500 increments. The maximum annual contribution was set at $5 000 from 2009 to 2012 and has stood at $5 500 since 2013. Over the years, saving, on which interest and returns are thus non-taxable, will become significant in scope.

The committee recommends that Québec, in collaboration with the federal government and the provinces, engage in reflection to better match the RRSP and the TFSA and thereby enhance the overall coherence of saving incentives.

Such reflection should, in particular, focus on:

— the contribution ceiling in each regime, in particular the TFSA, which could be limited to a certain lifetime amount, e.g. $100 000;

— the coordination of contributions to either regime, e.g. through the imposition of a common ceiling;

— the impact of either regime on the benefits paid under the guaranteed income supplement program.

Indeed, an RRSP withdrawal reduces the amount of the guaranteed income supplement to which a low-income earner may be entitled. The RRSP is not necessarily the best savings vehicle for an individual who is entitled to the guaranteed income supplement. The TFSA could prove to be a better planning tool.

PART 2:
CORPORATE TAXES

The committee's recommendations concerning corporate income tax are presented in five sections devoted to:

— reduction of the general tax rate;

— implementation of a "growth premium" for SMEs;

— a reduction in the payroll tax rate for SMEs;

— revision of tax expenditures;

— capital gains taxation.

1. REDUCTION OF THE GENERAL TAX RATE

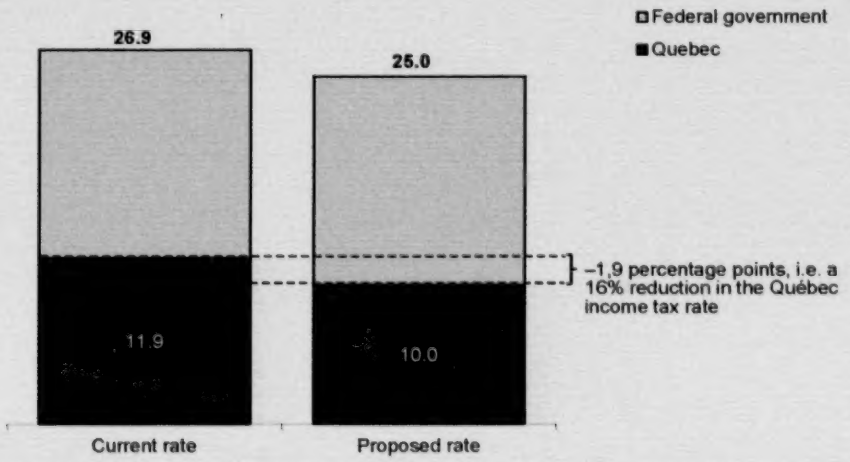
The committee recommends reducing from 11.9% to 10% the corporate income tax rate.

The reduction of nearly 2 percentage points in the tax rate corresponds to a reduction of nearly 16% in the tax rate. The tax rate combined with the federal rate would, accordingly, stand at 25%.

The tax reduction would represent a $675-million gain for corporations.

CHART 6

Corporate income tax rates
(percentage rate)



The reduced tax rate would improve Québec's tax competitiveness and foster economic growth. It would enhance the profitability of investments, thereby enabling businesses to invest more extensively in their growth. It would attract foreign firms to Québec.

The reduction in the general tax rate would offer Québec businesses Canada's lowest general income-tax rate, equivalent to that in Alberta.

❑ Arguments advanced by certain economists

In a study carried out at the committee's request, Jean-François Wen, Bev Dahlby and Ergete Ferede suggest that a reduction in the corporate tax rate and the elimination or reduction of the investment tax credit would enhance economic efficiency and long-term growth in Québec.[35]

In a previous study, Bev Dahlby and Ergete Ferede estimated that a one-percentage-point reduction in the provincial corporate tax rate would engender a 0.1- to 0.2-percentage-point increase in the provincial annual economic growth rate, which is considerable in the context of average annual real GDP growth on the order of 1.5%.[36]

Another study by Bev Dahlby concluded that the Canadian provinces would experience higher economic growth rates were corporate tax to be reduced for a higher sales tax or higher personal income tax. This conclusion assumes that the new tax mix would have zero cost, i.e. it would not affect tax revenues.[37]

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35 In the study, the authors do not produce estimates of the impacts for Québec on economic growth. Their conclusions stem from their estimates of the marginal cost of the public funds associated with various taxes. See Jean-François Wen, Bev Dahlby and Ergete Ferede, *Les implications des distorsions fiscales sur la réforme fiscale au Québec*, November 24, 2014, in Volume 5 of this report.

36 See Bev Dahlby and Ergete Ferede, "The Effects of Tax Rate Changes on Tax Bases and the Marginal Cost of Public Funds for Provincial Governments" in *International Tax and Public Finance*, Vol. 19, December 2012, pages 844-883, and Dev Dahlby, "Reforming the Tax Mix in Canada", *SPP Research Papers*, Vol. 5, No. 14, The School of Public Policy, University of Calgary, April 2012.

37 Bev Dahlby, "Reforming the Tax Mix in Canada" in *SPP Research Papers*, Vol. 5, No. 14, The School of Public Policy, University of Calgary, April 2012.

2. IMPLEMENTATION OF A "GROWTH PREMIUM" FOR SMES

The committee recommends the introduction of a "growth premium" for SMEs to replace the existing small business deduction.

Such a premium would cost the government $470 million.

The new "growth premium" would replace the existing small business deduction, which defines a reduced income-tax rate for SMEs, at a cost of $550 million. The new premium would cost $80 million less than the existing small business deduction.

2.1 Criticism of the existing small business deduction

The existing small business deduction is subject to widespread criticism.

The main reason mentioned to justify a reduced rate for SMEs is that the smallest enterprises find it harder than large companies to finance their operations or projects. According to research by the OECD, the studies conducted do not confirm the effectiveness of a reduced rate.[38]

The same study notes that specific treatment for SMEs appears to represent "a serious distortion, which dissuades businesses from achieving an optimum size to realize economies of scale." Accordingly, a tax system that is advantageous for small enterprises may adversely affect their growth.

Other data presented in the same study show that "a corporate tax reduction for large businesses would have a much more beneficial impact on growth than for small enterprises, partly because the latters' profitability is too limited to be appreciably affected by corporate tax."

The same reasoning appears to apply to manufacturing SMEs, which benefit in Québec from an additional enhancement of the small business deduction.

❑ Recognition of the Canadian context

However, in the Canadian context the committee notes that Québec SMEs are competing with SMEs from the rest of Canada, where specific, advantageous tax treatment more often than not exists.

For this reason, the committee recommends the maintenance of specific treatment for SMEs in the form of a "growth premium."

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[38] "La réforme fiscale au service de l'efficience et de l'équité" in OCDE, *Études économiques de l'OCDE : Canada 2008*, June 2008, pages 83-84.

2.2 The parameters of the new "growth premium"

The new "growth premium" would replace the existing small business deduction.

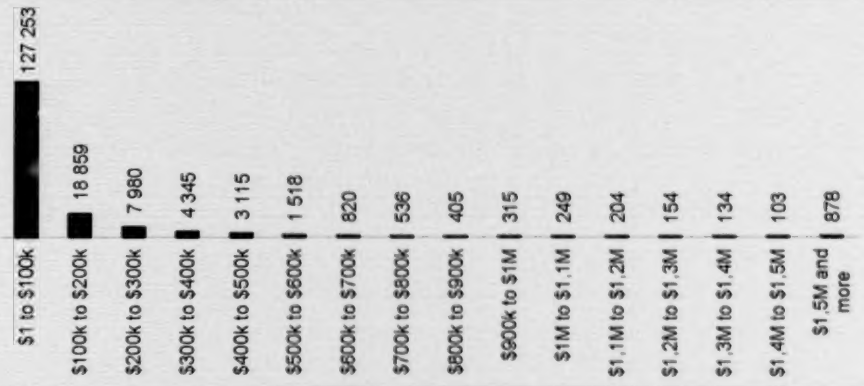
Eligibility for the new premium would be limited to Canadian-controlled private corporations with paid-up capital of less than $15 million, as is the case for the existing small business deduction.

The premium would take the form of a tax credit or a deduction for private companies that reduces from 10% to 4% the tax rate on corporate income on the taxable income bracket between $100 000 and $500 000.

The new premium would encourage small enterprises to grow in order to reach levels of income that benefit from favourable tax treatment.

CHART 7

Breakdown of the number of enterprises eligible for the small business deduction by taxable income bracket – 2011
(number)



Note: For Canadian-controlled private corporations with paid-up capital of less than $15 million.
Source: Revenu Québec taxation data.

❑ Correct an injustice

What is more, access to the rate would be limited to corporations with at least five employees.

Limiting access to the rate to corporations with at least five employees would also partly correct the injustice noted: a significant number of self-employed workers or professionals incorporate in order to take advantage of the tax benefits when activities are exercised through a corporation.

Incorporation gives them access to certain tax planning possibilities that allow, in particular, tax deferral, a significant tax benefit. Salaried workers are unable to resort to incorporation that allows for such benefits.

Without this exclusion, the "growth premium" would engender an additional cost of roughly $125 million.

❑ Greater neutrality

The "growth premium" that the committee is proposing would benefit businesses in all areas of activity, without distinction.

In relation to the existing small business deduction that offers preferential treatment to SMEs in the manufacturing sector, the "growth premium" would be more neutral and more equitable toward businesses in all sectors.

2.3 Impacts of the new "growth premium"

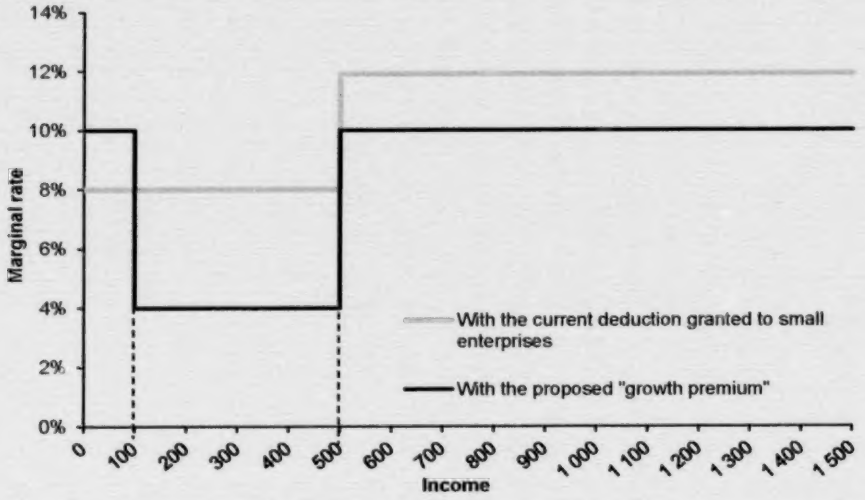
The new "growth premium" would affect the marginal tax rate of the businesses targeted and, consequently, their tax payable. The impact would vary according to the area of activity since the existing regime offers preferential treatment to enterprises in the manufacturing sector.

❑ Impact on SMEs in sectors other than the manufacturing sector

For eligible SMEs in sectors other than the manufacturing sector, the "growth premium" combined with the reduction in the income-tax rate from 11.9% to 10% would offer a marginal tax rate below the current rate for all corporations with taxable income exceeding $100 000.

CHART 8

Marginal tax rate on the income of an SME, except in the manufacturing sector – 2015
(percentage rate and income in thousands of dollars)



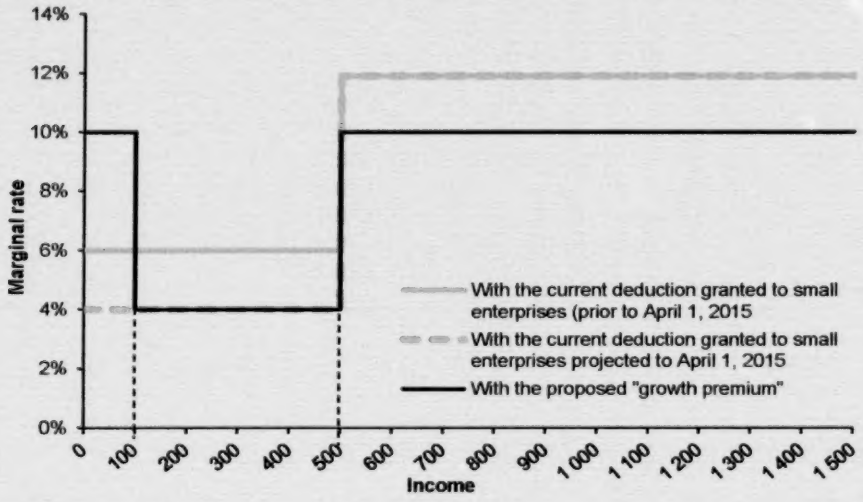
❑ Impact on SMEs in the manufacturing sector

For eligible SMEs in the manufacturing sector, which now benefit from preferential treatment in relation to other sectors, the marginal rate would be lower than or equal to the current rate for all income exceeding $100 000.

Compared with the rate announced effective April 1, 2015 applicable to them, the tax rate would be equivalent between $100 000 and $500 000 and lower on surplus income as a result of the proposed reduction in the tax rate.

CHART 9

Marginal tax rate on the income of an SME in the manufacturing sector – 2015
(percentage rate and income in thousands of dollars)



❑ A genuine "growth premium"

The application of the new "growth premium" would significantly reduce the effective tax rate as the company's income increases between $100 000 and $500 000.

The tax rate of small enterprises with less than $100 000 in taxable income would increase in relation to the application of the current deduction.

— The additional tax could not exceed $2 000, except in the manufacturing sector that now benefits from preferential treatment and in respect of which the maximum additional tax would be $4 000 or $6 000 commencing on April1, 2015, were the government to confirm the additional enhancement announced.

— Small enterprises would, however, have access to the reduced tax rates if they grow.

TABLE 17

Tax payable in the current situation and in the proposed situation, except for the manufacturing sector – 2015
($)

Taxable income	Current situation	The committee's proposal	Tax differential
100 000	8 000	10 000	2 000
250 000	20 000	16 000	-4 000
500 000	40 000	26 000	-14 000
750 000	69 750	51 000	-18 750
1 000 000	99 500	76 000	-23 500
1 250 000	129 250	101 000	-28 250
1 500 000	159 000	126 000	-33 000

TABLE 18

Tax payable in the current situation and in the proposed situation, manufacturing sector – 2015

($)

	Prior to April 1, 2015			Commencing on April 1, 2015		
Taxable income	**Current situation**	**The committee's proposal**	**Tax differential**	**Anticipated situation**	**The committee's proposal**	**Tax differential**
100 000	6 000	10 000	4 000	4 000	10 000	6 000
250 000	15 000	16 000	1 000	10 000	16 000	6 000
500 000	30 000	26 000	−4 000	20 000	26 000	6 000
750 000	59 750	51 000	−8 750	49 750	51 000	1 250
1 000 000	89 500	76 000	−13 500	79 500	76 000	−3 500
1 250 000	119 250	101 000	−18 250	109 250	101 000	−8 250
1 500 000	149 000	126 000	−23 000	139 000	126 000	−13 000

The committee's proposals and respect for the principle of integration

The principle of integration

To ensure the neutrality of the tax regime and avoid double taxation, an integration mechanism between the personal income tax system and the corporate taxation system has been established to make sure that dividend income is taxed at a similar rate to work income.[1]

Respect for the principle, in relation to the committee's proposals

New tax rates, such as those that the committee is proposing, would alter the neutrality of the taxation system for corporations.

To make the taxation system more neutral, the provincial rate of the increase and the dividend tax credit should be adjusted to take into account the new tax rates that the committee is proposing, both as regards the reduction in the general rate and the new growth premium.

1 For additional information, see Part 6 of Volume 3 of this report.

3. A REDUCTION IN THE PAYROLL TAX RATE FOR SMES

Québec collects from businesses a payroll tax called the Health Services Fund contribution.

The committee recommends reducing from 2.7% to 1.6% the rate of the payroll tax for SMEs, which would reduce their annual tax burden by $430 million.

A distinction must be made between this tax, which is paid into the Consolidated Revenue Fund, and payroll taxes, which are the employers' share to fund certain specific programs from which employees benefit.

3.1 The justification for differential treatment for SMEs

The Québec taxation system is noteworthy for its heavy payroll tax in relation to the other three provinces in which such a tax exists.

The payroll tax is a fixed charge that is more of a burden for SMEs than for large businesses. The fixed charge also imposes additional constraints respecting liquid assets for SMEs.[39]

Differential treatment is, therefore, warranted between small and large businesses in this instance.

[39] For additional information, see Part 6 of Volume 3 of this report.

3.2 A reduced rate for all sectors

The rate would apply to businesses in all sectors to avoid favouring a specific sector to the detriment of the others.

SMEs in the primary and manufacturing sectors have benefited from this rate since January 1, 2015. As for the other SMEs now subject to the 2.7% rate, they would enjoy a reduction in the payroll tax of more than 40%.

Social contributions

The burden of social contributions

In addition to the payroll tax, businesses must bear the additional expense of social contributions.

Québec does not stand out in terms of significantly higher social contributions than elsewhere, which is not true of the payroll tax. When exemptions and maximum insurable earnings are excluded, social contributions account for roughly 10.2% of the total payroll in Québec, compared with 10% in Ontario and 9.5% in the Canadian provinces overall.

However, the reduction in the payroll tax should not be perceived as a pretext for increasing the existing social contributions.

The "1% tax"

Corporations are obliged to devote 1% of their total payroll to manpower training. Those that fail to do so must pay the equivalent into a manpower training fund that the Commission des partenaires du marché du travail manages.

Although the measure is known as the "1% tax," it is not a fiscal measure. The committee did not, therefore, analyze it.

However, it is an expense on the total payroll that is added to taxes and other social contributions.

4. REVISION OF TAX EXPENDITURES

The report presents in three sections the findings of the analysis conducted on tax expenditures pertaining to corporate tax and the attendant recommendations.

— The first section examines a modification affecting most tax credits, i.e. the limitation of the refundability of tax credits to corporations.

— The second section presents in an orderly fashion the recommendations concerning most of the tax expenditures analyzed.

— The third section is devoted to certain specific tax measures that require a broader explanation.

4.1 Limitation of the refundability of tax credits to corporations

The committee has pinpointed a tightening measure that applies simultaneously to several tax expenditures, i.e. the elimination of the full refundability of tax credits for large businesses.

❑ A characteristic that applies to most tax credits granted to corporations

The refundability of tax credits is a general characteristic that applies to most tax credits granted to corporations.

In 2011, tax credits applicable to corporate tax cost $1.919 billion, of which the reimbursed portion stood at 82%.[40] This means that most of the tax credits that corporations claimed exceeded the tax payable, thereby giving rise of a reimbursement.

The concept of a refundable tax credit is not specific to Québec: other jurisdictions also offer refundable tax credits to support certain activities. However, Québec is noteworthy for the manner in which it uses this means of support: it virtually goes without saying that tax credits granted to corporations are refundable in Québec.

❑ A characteristic that engenders certain undesirable economic impacts

A number of companies benefit repeatedly from the refundability of tax credits although their tax payable year after year is lower than the value of the credits.

It is not desirable that, over a long period, corporations do not make sufficient profits to take advantage of the tax credits available to them. The existence of refundable tax credits does not encourage businesses to generate profits in Québec.

In the longer term, such a situation also deprives Québec of broader added value and the attendant spinoff.

[40] The amount of the tax credit exceeding the amounts of corporate income tax paid by the corporation, the tax on insurance premiums and the compensatory tax on financial institutions, but without taking into account the payment of the contribution to the Health Services Fund. When account is also taken of the contribution to the Health Services Fund, the reimbursed portion is instead 56%.

❑ For large businesses, termination of full refundability of corporate tax credits

For large businesses,[41] the committee recommends the termination of full refundability of corporate tax credits.

The committee believes that it is important to protect smaller businesses, in respect of which the refundability of tax credits could engender liquidity problems.

The committee therefore recommends that the principle of the refundability of tax credits be maintained in the case of Canadian-controlled private corporations whose taxable income is:

— less than $500 000 and whose consolidated global paid-up capital is less than $10 million (such corporations benefit from the refundability of the first $1 million of tax credit);

— between $500 000 and $800 000 or whose consolidated global paid-up capital is between $10 million and $50 million—such corporations benefit from the refundability on the first tax credit bracket the amount of which is reduced linearly from $1 million to zero between the two thresholds.

Refundability would be abolished for all other corporations.

The measure could be introduced gradually, over five years, to enable corporations to adapt to it.

■ Take into consideration the contribution to the Health Services Fund

Furthermore, the committee recommends that the contributions to the Health Services Fund for all corporations be considered in the determination of the refundable portion of the tax credit, in addition to income tax.

This measure would mitigate the impact of the termination of the refundability of tax credits.

Recognition of the contribution to the Health Services Fund would be of particular interest to the research and development sector. In manufacturing firms that are active in research and development, in particular, manpower represents a significant cost, and the total payroll eligible for the scientific research and experimental development tax credit tax is relatively small in relation to the company's total payroll.

The committee wishes to maintain substantial support for research and development because of the positive externalities that it engenders.

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[41] By large business the committee means a corporation whose global paid-up capital exceeds $50 million.

❑ Impact on businesses

The abolition of the refundability of tax credits following the guidelines that the committee is suggesting would affect nearly 700 of the 11 800 corporations that now receive a refundable fraction of tax credits. Roughly 94% of corporations would thus continue to benefit from the refundability of tax credits because of the exceptions defined earlier.

■ The termination of refundability would not terminate the tax credit

It must be emphasized that the termination of the refundability of tax credits for large businesses would not mean the termination of the tax credit itself.

Non-refundability consists in limiting the amount of the tax credit to the applicable tax expenses. If the applicable tax expenses are insufficient, the non-refundability of tax credits does reduce the amount of the tax credits that corporations obtain.

When the tax credit is non-refundable, corporations whose profits are insufficient to fully benefit from it may carry over the amount of the unused tax credits to their results for previous or subsequent years, according to a mechanism similar to that for carrying over losses.

By making the tax credit non-refundable, the government would only delay the time at which the corporation may benefit from it, insofar as, of course, it generates sufficient profits for this purpose.

The proposed measure would affect, in particular, corporations that, year after year, do not generate sufficient profits in relation to the tax credits that are now refundable. The proposed tightening measure should encourage corporations that engage in activities in several jurisdictions to declare in Québec a larger portion of their profits.

❑ Savings generated

This measure would in the long run generate annual recurring savings of $325 million, which would not be called into question if the corporations generated additional profits. In such a case, the payment of the tax credit would be made against the new tax revenues stemming from such profits.

■ Savings aimed at funding the proposed tax cuts

The committee made this recommendation to the government in its interim report to pinpoint immediate tightening measures to allow for the attainment of the objectives of Budget 2014-2015.[42]

The measures were proposed in the specific context of the budgetary targets defined by the government. The committee is maintaining this recommendation but this time pursuant to the proposed reform: the limitation of the refundability of tax credits would fund the reduction in corporate tax.

[42] Volume 4 of this report presents all of the proposals that the committee submitted.

4.2 Recommendations concerning most of the tax expenditures

The committee formulated recommendations following the application of the analytical grid that it defined.

The recommendations call for:

— abolishing certain tax measures;

— tightening the application parameters of certain tax credits;

— maintaining the status quo as regards certain measures.

❑ Abolish certain tax measures

The committee recommends the abolition of five tax measures pertaining to corporate tax.

It recommends the abolition of three of the measures because the number of taxpayers affected or the total amounts claimed are negligible, or because budget measures would better serve the desired objectives.

The measures are:

— refundable tax credit for taxi drivers and taxi owners;

— tax credit for technological adaptation services;

— additional deduction of 100% in the calculation of the income of the employer of the amount repaid to an employee to purchase an eligible mass transit fare or an eligible paratransit fare.

  Such assistance is very limited in overall government funding to encourage mass transit.

For various reasons, the committee also recommends that the following measures be abolished:

— refundable tax credit for the operator of an international financial centre;

  Although measure was revised in recent years, the data that the committee examined do not show that the measure is profitable nor that it makes it possible to create jobs with added value at reasonable cost. The committee recommends that the measure be abolished gradually over a period of seven years.

— tax credit relating to resources.

  The corporations targeted already benefit from the flow-through share regime. The committee recommends that the measure be abolished when economic conditions are favourable.

TABLE 19

Measures to be abolished – Corporate income tax

Measure	Number of beneficiaries in 2011[1]	Financial impact for the government[1] (millions of dollars)
1. Refundable tax credit for taxi drivers and taxi owners	190	0.3
2. Refundable tax credit for technological adaptation services	140	1.9
3. Additional deduction of 100% in the calculation of the income of the employer of the amount repaid to an employee to purchase an eligible mass transit fare or an eligible paratransit fare	n/a	0.2
4. Refundable tax credit for the operator of an international financial centre (IFC)	60	4.5
5. Tax credit relating to resources	240	75.6
TOTAL		**82.5**

Note: Estimate for 2013.
n/a: The number of beneficiaries or the financial impact is unavailable because of insufficient or missing data.
(1) The amount indicated corresponds to the impact in the long run, i.e. three years after the implementation of the tightening measure.

❑ Tighten the application parameters of certain tax credits

The committee recommends tightening the application parameters of two tax credits pertaining to corporate tax:

— refundable tax credit for design;

The committee recommends that the tax credit be available solely to the fashion sector.

In sectors other than the fashion sector, the tax credit is used instead on expenses that are incidental to research and development. Such expenses are thus part of the normal product development process and present a low level of risk. Furthermore, the tax credit benefits few businesses and usually for small amounts. Such expenses may be eligible for budgetary aid under the Créativité Québec program in the context of megaprojects.

— refundable tax credit for the reporting of tips.

When it was established in 1997, the measure was supposed to be temporary and was set at a rate of 100%. It was made permanent when the rate was reduced in 2003 to 75%. The committee recommends that the rate of the credit be reduced from 75% to 50% and that the measure's relevance be reassessed in five years.

TABLE 20

Measures to be tightened – Corporate income tax

Measure	Number of beneficiaries in 2013	Financial impact for the government[1] (millions of dollars)
1. Refundable tax credit for design	110	2.6
2. Refundable tax credit for the reporting of tips	6 300	26.9
TOTAL		**29.5**

Note: Estimate for 2013.
(1) The amount indicated corresponds to the impact in the long run, i.e. three years after the implementation of the tightening measure.

❑ Maintain the status quo as regards certain measures

The committee recommends maintaining the status quo for 51 tax expenditures concerning corporate tax.

■ Measures aimed at coherence, harmonization or avoiding double taxation

For the sake of the coherence of the taxation system, harmonization with the federal taxation system or to avoid double taxation, the committee recommends that the status quo be maintained with respect to the following measures:

- deductibility of land ownership fees;
- available-for-use rule;
- treatment of capital gains at the time of realization;
- deferral by means of billing-based accounting for certain professionals;
- deductions on instalment payments to entrepreneurs;
- preferential tax treatment accorded the agricultural sector or the fishing sector with regard to:
  - the possibility of using cash-based accounting;
  - flexibility in counting of inventories on hand.
- non-taxation of investment income from life insurance policies;
- non-taxation of the income outside Canada of life insurance companies;
- exemption from Québec tax on the profits of foreign maritime transport and air transport companies;
- capital cost allowance (surplus in relation to booked depreciation);
- deduction for investment corporations;
- surplus deduction for intangible fixed assets;
- deduction for entertainment expenses;
- exemption of the active income of the foreign subsidiaries of Canadian corporations to avoid double taxation;
- capital gains deferral by means of rollover provisions;
- exemption of registered charitable organizations and non-profit organizations;
- deductibility of gifts;
- exemption of government organizations.

- **Measures to recognize losses or that allow for their carry over**

The committee recommends the status quo concerning the measures that recognize losses or the authorization for carry over.

Since corporations are taxed on the their income, it is normal for the losses that they sustain to reduce their taxable income. It is a question of acknowledging the cyclical fluctuations that affect corporate income, especially in certain sectors. What is more, this situation is not specific to Québec.

Specifically, the measures focus on:

— deduction of eligible losses in respect of an investment in a business;

— capital losses;

— losses other than capital losses;

— farm and fishing losses;

- **Measures concerning natural resources or related to the mining regime**

The committee recommends the status quo concerning certain measures pertaining to natural resources or related to the mining regime:

— preferential tax treatment accorded resource-related expenses:

  — accelerated depreciation of Canadian exploration expenses;

  — accelerated depreciation of Canadian development expenses;

— preferential tax treatment accorded expenses related to renewable energies and energy conservation in Canada;

— preferential tax treatment accorded environmental trusts.

- **Measures deemed to be relevant as regards the objective that they pursue**

The committee recommends that the status quo be maintained with respect to measures deemed to be relevant because of the objective that they pursue and whose characteristics do not require their modification:

— deductibility of countervailing and anti-dumping duties;

— deductibility of earthquake reserves;

— tax credit for the construction or conversion of ships;

— deduction for renovations or alterations to facilitate access to a building;

— immediate deduction of advertising expenses;

— tax credit for traineeships in the workplace;

— assistance for the capitalization of the Réseau d'investissement social du Québec;

— of the dividends of savings and credit unions and cooperatives;

— deduction for logging tax;

— property tax refund for forest producers.

■ Measures whose termination has been announced

The committee recommends the status quo with respect to certain measures whose termination has been announced. It recommends that they not be renewed beyond the anticipated termination date.

Specifically, the measures focus on:

— tax credit for processing operations in resource regions;

— tax credit for the Aluminum Valley region;

— tax credit for the Gaspé Peninsula and certain maritime regions of Québec;

— tax credit for the production in Québec of ethanol and cellulosic ethanol;

— tax credit to foster the modernization of tourism accommodation;

— accelerated depreciation for manufacturing and processing equipment;

— tax credit for worker training in the manufacturing, forest and mining sectors;

— tax credit for market diversification for Québec manufacturing companies;

— temporary tax credit for damage insurance companies;

— additional deduction of 85% for certain trucks and tractors that run on liquefied natural gas.

  The environmental objectives targeted by this measure would be better served by a budget measure, such as the Green Fund.

■ Measures that have just been implemented

The committee recommends the status quo with respect to certain measures implemented in 2014, although they should be reassessed in five years in light of the outcomes obtained.

Specifically, the measures focus on:

— tax-free reserve for shipowners;

— additional deduction for the capital cost allowance of a vessel;

— additional deduction for the transportation costs of remote manufacturing SMEs;

— tax credit for interest payable on financing obtained through La Financière agricole du Québec's seller-lender formula.

TABLE 21

Measures that must remain unchanged – Corporate income tax

Measure	Number of beneficiaries in 2011	Cost[1] (millions of dollars)
1. Deductibility of land ownership fees	n/a	n/a
2. Available-for-use rule	n/a	n/a
3. Treatment of capital gains at the time of realization	n/a	n/a
4. Deferral by means of billing-based accounting for certain professionals	n/a	n/a
5. Deductions on instalment payments to entrepreneurs	n/a	5
6. Possibility of using the cash-based accounting method for the agricultural sector or the fishing sector	n/a	n/a
7. Flexibility in the method of counting inventories on hand for the agricultural sector or the fishing sector	n/a	n/a
8. Non-taxation of investment income from life insurance policies	n/a	n/a
9. Non-taxation of the income outside Canada of life insurance companies	n/a	n/a
10. Exemption from Québec tax on the profits of foreign maritime transport and air transport companies	n/a	n/a
11. Capital cost allowance (surplus in relation to booked depreciation)	n/a	n/a
12. Deduction for investment corporations	n/a	n/a
13. Surplus deduction for intangible fixed assets	100 000	f
14. Deduction for entertainment expenses	112 000	49
15. Exemption of the active income of the foreign subsidiaries of Canadian corporations to avoid double taxation	n/a	n/a
16. Capital gains deferral by means of rollover provisions	n/a	n/a
17. Exemption of registered charitable organizations and non-profit organizations	n/a	n/a
18. Deductibility of gifts	19 000	35
19. Exemption of government organizations	n/a	n/a
20. Deduction of eligible losses in respect of an investment in a business	500	8
21. Capital losses	10 000	68
22. Loss carry-overs other than capital losses	55 000	738
23. Farm and fishing losses	1 000	3
24. Accelerated depreciation of Canadian exploration expenses	n/a	n/a
25. Accelerated depreciation of Canadian development expenses	n/a	n/a
26. Preferential tax treatment accorded expenses related to renewable energies and energy conservation in Canada	n/a	n/a
27. Preferential tax treatment accorded environmental trusts	c.d.	f
28. Deductibility of countervailing and anti-dumping duties	n/a	n/a
29. Deductibility of earthquake reserves	n/a	f

TABLE 21

Measures that must remain unchanged – Corporate income tax (continued)

Measure	Number of beneficiaries in 2011	Cost (millions of dollars)
30. Tax credit for the construction or conversion of ships	c.d.	7
31. Deduction for renovations or alterations to facilitate access to a building	c.d.	f
32. Immediate deduction of advertising expenses	n/a	6
33. Tax credit for traineeships in the workplace	5 000	39
34. Tax assistance for the capitalization of the Réseau d'investissement social du Québec	n/a	n/a
35. Deduction of the dividends of savings and credit unions and cooperatives	400	45
36. Deduction for logging tax	150	f
37. Property tax refund for forest producers	800	7
38. Tax credit for processing operations in resource regions	330	21
39. Tax credit for the Aluminum Valley region	50	7
40. Tax credit for the Gaspé Peninsula and certain maritime regions of Québec	90	16
41. Tax credit for the production in Québec of ethanol and cellulosic ethanol	c.d.	f
42. Tax credit to foster the modernization of tourism accommodation	60	8
43. Accelerated depreciation for manufacturing and processing equipment	4 500	22
44. Tax credit for worker training in the manufacturing, forest and mining sectors	100	f
45. Tax credit for market diversification for Québec manufacturing companies	c.d.	f
46. Temporary tax credit for damage insurance companies	300	12
47. Additional deduction of 85% for certain trucks and tractors that run on liquefied natural gas	c.d.	f
48. Tax-free reserve for shipowners	—	—
49. Additional deduction for the capital cost allowance of a vessel	—	—
50. Additional deduction for the transportation costs of remote manufacturing SMEs	—	—
51. Tax credit for interest payable on financing obtained through La Financière agricole du Québec's seller-lender formula	—	—
TOTAL		**1 096**

Note: Estimate for 2013.
n/a: The number or cost is unavailable because of insufficient or missing data.
c.d.: Confidential data. Fewer than 10 business beneficiaries.
f: The fiscal cost is less than $2 million.
—: No data. The measure was implemented after 2013.

4.3 Measures concerning certain specific tax expenditures

Certain specific tax measures pertaining to more complex fiscal concepts or that require fuller explanations are presented in detail below:

— certain sectorial tax credits;

— investment assistance;

— tax credits that target the cultural sector.

❑ Revision of certain sectorial tax credits

■ tax credit for the production of multimedia titles

The tax credit has had a direct impact on the establishment and growth in Québec of a rapidly expanding sector the world over. Between 2012 and 2016, the global video game market is expected to grow by 7.2% annually, to $83.0 billion in 2016.[43]

Other jurisdictions exert very stiff tax competition on Québec and engage in genuine tax competition in the sector. While the competing jurisdictions, including Québec, lose out broadly speaking, it is impossible to unilaterally terminate it. The companies concerned are extremely mobile. The vast majority of large firms in the video game sector in Québec are foreign corporations that can easily delocalize.

The committee notes that the tightening measures adopted in June 2014 within the framework of a parametric cut in all business tax credits might compromise the sector's development in Québec.

However, Montréal benefits from other advantages that must be recognize, in particular a well-developed sector that has achieved a sound level of productivity, and creative, quality manpower.

▪ The enhancement of the tax credit for the production of multimedia titles

The committee recommends that the tax credit for the production of multimedia titles be enhanced to partly reverse the tightening measure adopted in June 2014. The Category 1 rate would increase from 24% to 28%. The Category 2 rate would increase from 21% to 25%. The rate of the French production premium eligible for Category 1 would be increased from 6% to 7%.

However, the committee recommends that the enhancement of the tax credit rate be accompanied by a ceiling on the tax credit equivalent to $25 000 per year per eligible job.

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[43] PwC, *Global Entertainment and Media Outlook: 2012-2016*, June 2012.

■ Scientific research and experimental development tax credit

Investments in research and development are essential to ensure the presence in Québec of efficient businesses that offer products adapted to changing worldwide demand.

Tax measures directly affect the competitiveness of businesses that invest in research and development. The committee recognizes that investments in research and development encompass positive externalities, i.e. advantages that affect society as a whole. In the absence of government support, some of the investments would be threatened.

For all of these reasons, tax assistance for research and development must be maintained.

▪ Other costs

Furthermore, the committee has observed that:

— Québec firms experience considerable difficulty in marketing the outcomes of research and development;

— research and development efforts do not translate into intellectual property;

— the government's tightening measures in respect of this tax credit in the December 2014 *Update on Québec's Economic and Financial Situation*—the establishment of a minimum expenditure threshold of $50 000 for corporations with assets equivalent to or less than $50 million— significantly reduced the advantage accorded SMEs in relation to big businesses.

▪ Maintenance of the tax credit

Based on its observations, the committee recommends the maintenance of the tax credit in its current form and, more specifically:

— the maintenance at 14% of the rate of the scientific research and experimental development tax credit for large businesses;

— the maintenance at 30% of the rate of the scientific research and experimental development tax credit for SMEs;

— the introduction of budget measures to support the marketing by SMEs of the outcomes of research and development.[44]

[44] For additional information, see Part 6 of Volume 3 of this report.

■ The tax credit for the development of e-business

Competition in the sector that this tax credit targets is not as keen as in other sectors. While information technologies service firms are partly mobile, a fraction of their operations with high added value cannot be delocalized without high risk of adversely affecting service quality.

What is more, the sector has attained maturity and significant tax assistance for it does not seem warranted.

However, the government has already announced that the tax credit would be in force until December 31, 2025.

▪ The maintenance of the tax credit until its scheduled expiry

The committee recommends that the tax credit for the development of e-business be maintained until its anticipated expiry date on December 31, 2025 but that it not be renewed thereafter.

▪ One avenue has been rejected

The committee examined the possibility of excluding public contracts from eligibility for the tax credit. It did not adopt this avenue since its economic impacts would be uncertain and might reduce the competitiveness of small enterprises, thereby reducing competition in the sector.

■ The tax credit for the integration of IT in manufacturing SMBs

One of the objectives of the tax credit for the development of e-business was to foster the introduction of information technologies in Québec manufacturing enterprises.

To this end, the government should not target the supply of technologies but demand by intervening directly among Québec manufacturing enterprises.

The committee recommends that the moratorium on the tax credit for the integration of IT in manufacturing SMBs be lifted.[45]

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[45] For additional information on the moratorium, see Ministère des Finances du Québec, *Budget 2014-2015 – Budget Plan*, June 2014, page A.87.

The integration of IT in manufacturing SMBs

SMEs are facing a productivity problem linked to significant under-investment in information technologies, i.e. software and telecommunications equipment.

- Such firms lack the cash resources to invest and integrate information technologies into their business processes.
- Their risk tolerance threshold is much lower and they have access to financing less readily than large corporations.

SMEs are lagging significantly in the integration of the information technologies in relation to their competitors in neighbouring jurisdictions.

- The integration of management software packages remains limited in Québec SMEs even though such packages are an excellent way to achieve performance gains as regards the operation and management of the company.
- Québec SMEs perform well from the standpoint of the use of integrated management software packages. Such is not the case with respect to customer relationship management software packages and supply chain management software.

Utilization rate of management software packages in Canadian SMEs
(as a percentage)

	Integrated management software packages	Customer relationship management software packages	Supply chain management software packages
Canada	24.9	23.9	12.0
Québec	**32.2**	**22.2**	**8.0**
Ontario	24.5	27.3	15.9
British Columbia	17.4	22.6	9.9

Source: Cefrio, NetPME 2011 – L'utilisation des TIC par les PME canadiennes et québécoises.

❑ Revision of investment assistance

■ The C2i tax holiday for major investment projects

The tax holiday attracts direct foreign investments but also encourages businesses established in Québec to undertake major expansion projects.

In all likelihood, the projects would not be carried out in Québec without such assistance. The investments can, potentially, be carried out in all regions of Québec.

By targeting projects with significant spinoff, the tax holiday is a worthwhile strategic tool.

- **The maintenance and reassessment of the measure**

The committee recommends the maintenance of the C2i tax holiday for major investment projects.

However, upon its scheduled expiry in 2015, the outcomes obtained should be examined to ascertain its genuine impact and use before it is extended.

■ Investment tax credit

This tax credit replaces the former tax credit on wages for the regions. Although it is preferable to the former tax credit on wages, the committee does not believe that it effectively fosters investment.

In 2008, the Task Force on Business Investment noted that a reduction to 10% of the general tax rate was preferable to a general investment tax credit.[46]

- **Non-renewal of the tax credit**

The committee recommends the immediate abolition of the basic investment tax credit rates applicable to the central regions.

For the regions eligible for the enhanced rate, i.e. remote and intermediate regions, the committee recommends the complete abolition in 2018. Until the tax credit's abolition, the rate applicable in the regions would be adjusted according to the immediate abolition of the tax credit for central regions.

At present, the rate in the central regions is 8% for SMEs and 4% for corporations with paid-up capital equivalent to or greater than $500 million. Since it would be abolished, the rate applicable in remote and intermediate regions would be reduced by 8 percentage points for SMEs and by 4 percentage points for large businesses, until the complete abolition of the tax credit.

[46] *Québec Welcomes Investment – Report of the Task Force on Business Investment*, Québec, March 2008, page 167.

The report of the Task Force on Business Investment

The Task Force on Business Investment was established in 2007 to "help the government identify ways to increase investment to sustain economic growth."[1] Chaired by Pierre Fortin, the task force comprised Andrée Corriveau and Jean Boivin.

At the conclusion of its deliberations, in March 2008, it submitted to the government a report containing 21 recommendations.

Recommendation 2 reads as follows:

> "The Task Force recommends that the government reduce the general corporate tax rate to 10% by 2012, rather than introduce a generalized tax credit on investment."[2]

The task force justifies this recommendation by emphasizing that numerous analyses confirm that corporate income tax has a significantly negative impact on investment.

A generalized investment tax credit has several drawbacks, including its adoption by the suppliers of capital goods and the exclusivity of the advantage accorded tangible capital.

However, a targeted tax credit for a major economic or social purpose is a major intervention tool that allows for flexibility. The government should not abandon this type of tax credit.[3]

1 *Québec Welcomes Investment – Report of the Task Force on Business Investment*, Québec, March 2008, page XXIII.
2 *Ibid.*, page 167.
3 *Ibid.*, page 168.

❑ Revision of tax assistance for enterprises in the cultural sector

The tax assistance accorded enterprises in the cultural sector includes the seven main tax credits:

— tax credit for Québec film or television production;

— tax credit for film production services;

— tax credit for the production of sound recordings;

— tax credit for the production of performances;

— tax credit for book publishing;

— tax credit for film dubbing;

— tax credit for the production of multimedia environments or events staged outside Québec.

The total value of the tax credits will stand at $196 million by 2018-2019.

The committee believes that it is desirable to maintain this support for the cultural sector.

The tax assistance does not pursue economic goals alone. It also targets cultural objectives, i.e. to offer Quebecers original cultural production, mainly in French, and to broaden the influence of Québec culture abroad.

Moreover, digitization is multiplying the exhibition windows for cultural content. Québec productions compete with foreign productions that have available considerable financial resources.

The committee therefore recommends the maintenance or the enhancement of certain measures. It nevertheless recommends that certain credits be reviewed or indeed eliminated.

More specifically, the committee recommends:

— the maintenance of the tax credit for Québec film or television production, with the addition of a ceiling on eligible salaries;

— the abolition in the long run of the tax credit for film production services;

— the enhancement of the tax credit for the production of sound recordings and the tax credit for the production of performances, with the addition of a ceiling on eligible salaries of $100 000 per job per year;

— the enhancement of the tax credit for film dubbing;

— the enhancement of the tax credit for book publishing;

— the maintenance of the tax credit for the production of multimedia environments or events staged outside Québec.

Support for the cultural sector: for-profit and non-profit organizations

The tax assistance accorded the cultural sector only benefits some cultural organizations, i.e. for-profit organizations. Indeed, by definition tax credits are not intended for non-profit organizations, which are non-taxable.

If we take, for example, the case of shows, song, variety or non-sung popular music shows and theatre performances are mainly associated with productions supported by tax credits. On the other hand, dance and classical music performances are largely produced by non-profit organizations funded for the most part by budget measures.

■ Tax credit for Québec film or television production

This is the biggest tax credit and accounts for $110 million out of total spending of $196 million for the seven tax credits pertaining to the cultural sector.

It is important for the entire Québec film and television industry since it supports Québec production.

- **The maintenance of the tax credit and the addition of a ceiling on eligible salaries**

The committee recommends that the tax credit be maintained for a period of at least five years to ensure the stability of financing for the sector.

However, the committee recommends that a ceiling of $100 000 per job per year be added in respect of salaries eligible for the tax credit to limit its costs and avoid abuses. There is currently no ceiling on the eligible salaries.

■ Tax credit for film production services

This tax credit represents an expense of $60 million. It seeks to support foreign film productions filmed in Québec.

While foreign film shooting enables Québec technicians and artists to work on film sets with considerable financial resources, the tax credit for film production services does not constitute direct assistance for Québec culture.

Despite perceptions, the profitability for Québec of such productions is hardly conclusive. Even if jurisdictions outdo each other to attract them, numerous studies, most of them American, show that there is little genuine spinoff.

Internal analyses conducted by the Ministère des Finances also indicate that the Québec tax credit is not profitable.[47]

The cost of the credit has risen considerably since 2010 because of the enhancement of the assistance. The tax expenditure increased from $14 million in 2009 to more than $50 million starting in 2010.

- **Abolition upon expiry of the tax credit**

The committee therefore recommends that the status quo be maintained for the next five years to enable the industry to adapt. The tax credit would then be abolished gradually between 2020 and 2023.

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[47] For additional information, see Part 6 of Volume 3 of this report.

■ Tax credit for the production of sound recordings and tax credit for the production of performances

The two tax credits directly target Québec cultural production and are relatively inexpensive.

The tax credit for the production of sound recordings ($1 million) supports the recording of discs by Québec artists. The tax credit for the production of performances ($14 million) supports the creation of an array of performances.

The committee recognizes the contribution that the two tax credits make to cultural creation in Québec both in the music and performance sectors.

▪ Enhancement of the tax credits and the addition of a ceiling on eligible salaries

The committee recommends the enhancement of the tax credit rate to restore the rate in force prior to the June 2014 Budget. The enhancement would cost the government $3 million.

However, the committee recommends tightening measures in respect of the salaries eligible for the tax credits. It recommends the application of a ceiling of $100 000 per job per year on eligible salaries. At present, no ceiling applies.

Follow-up similar to that applied to research and development should be carried out to ensure that the ceiling is not circumvented through the use of related enterprises based on the notion of the non- arm's-length relationship.

■ Tax credit for film dubbing

The tax credit for film dubbing allows for the dubbing in French in Québec of foreign films, above all American films. The dubbing of the films by Québec artists gives Quebecers access to French versions that draw closer to Québec culture and feature Québec voices.

The activity also represents for the artists supplementary income that enables them to live better from their profession.

The sector is subject to keen international competition and is one in which costs and the size of the market largely influence decisions on where to locate.

▪ Enhancement of the tax credit

Film dubbing is facing very stiff competition. The committee recommends the enhancement of the tax credit rate to restore the rate in force prior to the June 2014 Budget. The enhancement would cost an additional $1 million.

However, the committee has noted that the application of the tax credit has raised salaries in the sector. Reflection on the level of salaries therefore seems essential to bolster Québec's competitiveness. Given the industry's project-based structure, it would, however, be difficult to apply a ceiling on eligible salaries under the tax credit.

The increase in salaries in the film dubbing sector

Since the introduction of the tax credit for film dubbing, the remuneration of actors has absorbed a considerable share of the increase in the value of the contracts in the dubbing industry and experienced the biggest growth in relative terms.

Indeed, the amount earmarked for the remuneration of actors increased from 24.4% of the total value of contracts in 1998 to 28.9% in 2008.

During the same period, the remuneration of other professional services remained fairly constant (just over 20% of the total value of contracts).

Breakdown of dubbing contract costs between 1998 and 2008
(thousands of dollars, unless otherwise indicated)

		Cost of manpower					
Year	Value of contracts	Actors' remuneration	As a %	Remuneration, other services	As a %	Total payroll	Other dubbing costs
1998	8 703.2	2 123.9	24.4	1 757.1	20.2	3 881.0	4 822.2
2001	12 705.6	3 140.4	24.7	2 852.0	22.4	5 992.4	6 713.2
2005	17 564.9	4 684.9	26.7	3 586.7	20.4	8 271.6	9 293.3
2008	23 600.0	6 809.8	28.9	4 758.8	20.2	11 568.6	12 031.4

Source: Institut de la statistique du Québec and Ministère des Finances du Québec.

■ Tax credit for book publishing

The tax credit supports literary creation in Québec and costs $7 million.

The committee believes that this support is better targeted than the zero-rating of the QST on books sold in Québec.[48]

Indeed, the zero-rating of books applies to all printed books published in Québec or elsewhere. Accordingly, it applies both to imported and Québec books. The tax credit for book publishing only covers Québec publishers.

- **Enhancement of the tax credit**

The committee recommends the enhancement of the tax credit rate to restore the rate in force prior to the June 2014 Budget. The enhancement would cost an additional $1.5 million.

■ Tax credit for the production of multimedia environments or events staged outside Québec

The tax credit supports the dissemination of the productions of Québec artists using new technologies to produce multimedia environments or events.

It facilitates the dissemination abroad of original works and enhances Québec's influence.

- **Maintenance of the tax credit**

The committee recommends that the status quo be maintained as regards this tax credit.

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[48] See page 145.c

5. CAPITAL GAINS TAXATION

As is the case for personal income tax, the committee recommends the revision of the tax treatment of the capital gain for corporations.

In 2013, the partial inclusion for corporations of capital gains represented a tax expenditure of $361 million.

The inclusion rate of 50% now in force, which is identical to the rate from which individuals benefit, is arbitrary. It was established in a fiscal context where corporations were taxed at a rate that was substantially higher than it is now.

Accordingly, the committee recommends that 100% of capital gains be included in taxable income, with compensation aimed at taking into account inflation, according to the method proposed in respect of personal income tax.

As is the case in the recommendation concerning capital gains taxation for individuals, the change requires coordination with the other provinces and the federal government in order to maintain the Québec taxation system's competitiveness.

Provision would have to be made for certain exclusions in the case of the reconstruction of companies.

PART 3:
CONSUMPTION TAXES

The committee's recommendations concerning consumption taxes are presented in four sections devoted to:

— revision of consumption tax rates;

— application of new taxes;

— revision of tax expenditures;

— collection of taxes related to e-commerce.

1. REVISION OF CONSUMPTION TAX RATES

The committee recommends an increase in the rate of certain consumption taxes, which would generate $2.665 billion in additional tax revenues.

Extensive investigations have been conducted in recent years in the developed countries to analyze the impact of different methods of taxation on economic growth. Generally speaking, the studies reveal that income taxes are more detrimental than consumption taxes.

Broader reliance on consumption taxes combined with a reduction in the taxation of income would, therefore, foster Québec's economic growth.

1.1 An increase in the QST rate

The QST rate now stands at 9.975% and the combined rate with the GST is 14.975%.

❑ A lower rate than in a number of countries

The combined rate is lower than the rate applied in most of the OECD countries and is also lower than the average rate for the member countries overall (19.1%).[49]

The value-added tax in 21 of the 34 OECD countries is 20% or more. The rate is 24% or 25% in the Scandinavian countries.

■ The North American context must be considered

However, the North American context limits the increase that Québec might contemplate.

In the United States, no federal value-added tax is applied but certain states levy a sales tax. In Canada, the average rate of the combined sales tax is 12.3%. Only Nova Scotia applies a provincial sales tax higher than Québec's, i.e. 10%.

❑ An increase the QST rate to 11%

The committee recommends a 1.025-percentage-point increase in the rate of the QST, from 9.975% to 11%.

The combined QST and GST rate would thus increase to 16%, which is still lower than in many countries, but reasonable in the Canadian and North American context.

The increase would generate $1.294 billion in revenue.

To compensate the most disadvantaged for the increase in the QST, the committee recommends a $310-million enhancement of the solidarity tax credit. When account is taken of such compensation, the net revenue stemming from the tax increase would be $984 million.

[49] For additional information, see Part 7 of Volume 3 of this report.

1.2 An increase in the rate of the tax on insurance premiums

In Québec, insurance premiums are not subject to the QST but to the tax on insurance premiums at the rate of 9%.

One exception is individual insurance of persons, such as life insurance, health insurance and accident insurance, for which premiums are not taxed.

❑ Standardize at 11 % the rate of the tax on insurance premiums and the QST

The committee recommends that the rate of the tax on insurance premiums be harmonized with that of the QST and be set at 11%. Personal insurance premiums that are now exempt would continue to be so.

The increase would generate $391 million in revenue.

1.3 The application of the principle of the luxury tax: an increase in the additional motor vehicle registration fee on luxury vehicles

It may be hard to apply the principle of the luxury tax in the context of the QST. However, an additional motor vehicle registration fee is already levied on luxury vehicles.

The rate is now 1% of the value of a vehicle that exceeds $40 000.

❑ An increase in the additional registration fee applied to luxury vehicles of more than $50 000

The committee recommends that the additional registration fee applied to luxury vehicles of more than $50 000 be increased and adjusted.

Accordingly, the rate would:

— remain at 1% on the portion of the value exceeding $40 000, up to a maximum of $50 000;

— increase from 1% to 2% on the portion of the value exceeding $50 000, up to a maximum of $60 000;

— increase from 1% to 3% on the portion of the value exceeding $60 000.

The measure would generate $11 million in revenue.

■ The exclusion of electric vehicles

The committee also recommends that electric vehicles no longer be subject to the additional fees in order to recognize their environmental benefits.

❑ Another additional motor vehicle registration fee that was recently increased

Vehicles equipped with high displacement engines are also subject to a contribution.

Since the government just increased it in the *Update on Québec's Economic and Financial Situation,* the committee does not believe that an additional increase is warranted. However, it supports the increase announced.

The two fees have the advantage of also constituting a form of eco-taxation that promotes the principle of sustainable development.

1.4 An increase in the rate of certain taxes

Certain goods are subject to a specific tax in addition to the QST. The specific taxes are calculated according to a unitary rate per unit of the goods sold instead of according to a percentage of their selling price.

This is true of taxes on tobacco products, alcoholic beverages and fuel. The committee is proposing changes to each of the taxes.

❑ The specific tax on tobacco products

The tax on tobacco products is one of the best ways to combat smoking.

A comparison of current taxation in Québec of such products with that applicable in neighbouring jurisdictions affords latitude for an additional increase.

■ An increase of $5 per carton of 200 cigarettes over five years

The committee recommends that the rate of the specific tax on tobacco products be increased $1 per year per carton of 200 cigarettes for five years.

In the long run, the increase would generate $160 million in revenue.

However, the government should be vigilant to avoid a revival of smuggling activities and monitor the situation.

■ The requirement of a sales permit

The committee also recommends that merchants be obliged to obtain a sales permit for tobacco products.

The obligation to possess a permit at an annual cost of $250 would generate $2 million in revenue annually.

The Service de lutte contre le tabagisme in the Ministère de la Santé et des Services sociaux ensures an inspection service for tobacco retailers in Québec. For example, the service evaluates the compliance of signs and posters and the display of tobacco products. The inspection service engenders costs for the government. The adoption of a permit subject to a fee for tobacco retail outlets would fund the service.

The case of e-cigarettes

E-cigarettes have not yet been approved in Canada. To date, no e-cigarette product has been approved for sale in the country.

Until analyses of the product's composition are completed, the committee is unable to determine whether the product might be deemed to fall into the same category as tobacco products.

For this reason, it has not formulated any recommendation concerning the specific taxation of e-cigarettes.

❑ The specific tax on alcoholic beverages levied on beer

The specific tax on alcoholic beverages applies to beer, wine and spirits. The rate of the tax on beer is $0.63 per litre and on wine and spirits, $1.40 per litre.

The prices observed in neighbouring jurisdictions, including taxes, allow for an additional increase with respect to beer.

The price difference stems not only from the taxes applicable but also from the impact on prices of the rules governing sales, i.e. over-the-counter or government-controlled sales.

■ An increase of $0.39 per litre over five years

The committee recommends that the tax on alcoholic beverages be increased by an additional $0.078 per litre of beer each year for five years, i.e. by $0.39 per litre in the long run, thereby ultimately generating annual revenues of $210 million.

❑ The specific tax on fuel levied on gasoline and diesel

Different rates of the specific tax on fuel apply according to the type of fuel. It stands at 19.2 cents per litre of gasoline and 20.2 cents per litre of diesel.

Gasoline used for transportation is a significant source of greenhouse gases. Transportation by automobile also engenders traffic congestion problems whose economic consequences are considerable.

These negative externalities warrant levying significant taxation in order to change behaviour

■ An increase of $0.05 per litre over five years

The committee recommends that the fuel tax on gasoline and diesel be increased by 1 cent per litre per year for five years to send a clear signal to promote reduced consumption and to give taxpayers time to adapt.

The proposal would ultimately generate $600 million in tax revenues and would complement the anticipated impact of the application of the GHG emission cap-and-trade system.

The GHG emission cap-and-trade system

The GHG emission cap-and-trade system is a flexible market mechanism used to induce a carbon cost in business decision-making pertaining to investment, production and so on, and to promote the adoption of clean technologies.

The most efficient businesses that reduce their greenhouse gas emissions below their rights may sell the surplus on the carbon market, thus enabling them to wholly or partially recover the cost of their investments.

The businesses whose greenhouse gas emissions exceed their rights may choose to invest in green technologies or purchase rights to fulfil their regulatory obligations.

Two phases

The implementation of the GHG emission cap-and-trade system was planned in two phases. Accordingly, enterprises that emit more than 25 kilotonnes of CO_2 equivalent have had to offset their greenhouse gas emissions by means of rights under the GHG emission cap-and-trade system:

- since 2013 for the industrial sector and electricity generation;
- since 2015 for fuel and fossil fuel distributors.

2. THE APPLICATION OF NEW TAXES

2.1 A possible tax on residential Internet services, in particular to support cultural funding

A number of cultural products, in particular musical works or downloaded films, come from suppliers outside Québec. The suppliers are not obliged to collect the QST and Québec is losing several million dollars in revenue.

Moreover, sharing cultural content on the Internet can reduce the income that artists derive from their work.

The committee therefore recommends to the government that it examine the possibility of levying a tax on residential Internet services in order to support, in particular, the funding of existing tax measures or new culture-related measures.

❑ An illustration

In Québec in 2014, just over 2.8 million households used residential Internet services at an average annual cost, excluding taxes, of roughly $420.

For illustrative purposes, to generate roughly $50 million in revenue annually with such a tax, it would be necessary to levy:

— a tax of just over 4% on the cost of Internet services;

— a set tax of $17.45 per year (or $1.45 per month) per household with Internet access.

The taxes would be added to the sales taxes already applicable to such services.

3. REVISION OF TAX EXPENDITURES

The report presents in two sections the findings of the analysis conducted on tax expenditures pertaining to consumption taxes and the attendant recommendations.

— The first section presents in an orderly fashion the recommendations concerning most of the tax expenditures analyzed.

— The second section is devoted to certain specific tax measures that require a broader explanation.

3.1 Recommendations concerning most of the tax expenditures

The committee formulated recommendations following the application of the analytical grid that it defined.

❑ Abolish certain tax expenditures

The committee recommends the abolition of seven tax expenditures related to consumption taxes.

■ Measures that are hardly used or whose objectives would be better achieved by other means

The committee recommends the abolition of certain measures because they affect too few taxpayers, are unfair to other taxpayers, or the desired objectives would be better served by budget measures:

— refund in respect of automatic door openers for use by persons with a disability;

This highly targeted measures only benefits annually 10 or so taxpayers. The objective that the measure targets would be better served by budgetary aid.

— exemption accorded to the Société Saint-Jean-Baptiste de Montréal;

The measure is a specific exemption stemming from a statute specific to the organization. No other non-profit organization benefits from such treatment. The committee is not calling into question support for the organization but such differential treatment seems unwarranted. If need be, the government can support the organization financially by other means.

— reduction in the rate of the specific tax applicable to beer sold by microbreweries and the tax on alcoholic beverages sold by small-scale producers;

The reduction is intended to enhance the competitiveness of small-scale producers of beer, wine, cider and any other alcoholic beverage. The measures go against the principle of neutrality and accord an advantage to small producers in a specific sector in relation to other small producers in another area of activity. What is more, the specific tax on alcoholic beverages was implemented to take into account the negative externalities that alcohol consumption can engender and such externalities exist for both small and large producers.

— zero-rating of children's diapers and breast-feeding items;

While the zero-rating of children's diapers and breast-feeding items can be attractive from a political standpoint, it runs counter to the principle of neutrality. There are other ways of more effectively helping families with young children.

The study that Alain Charlet and Stéphane Buydens produced at the committee's request devoted to consumption taxes concurs with this observation.[50]

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[50] See Alain Charlet and Stéphane Buydens, *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation*, 2014, in Volume 5 of this report.

— zero-rating of books;

The zero-rating of books is a specific feature of the QST system. Indeed, the GST applies to books. The zero-rating of books was implemented to promote the book publishing industry, which is central to Québec's specific character, and to maintain accessibility to books. The committee believes that zero-rating is not the best way to attain these objectives. It would be more appropriate to tax books and reallocate the funds generated to the book publishing industry and its promotion.

— tax refund accorded the purchasers of new homes;

The tax refund accorded the purchasers of new homes was implemented to make home ownership accessible to most households and so that the application of the QST would have only a negligible impact of new home prices. The committee recommends that the rate of the tax refund gradually be reduced to zero.

— tax refund granted to the lessors of new residential apartment buildings.

The tax refund granted to the lessors of new apartment buildings sought to reduce a portion of the QST that buyers and builders of apartment buildings had to pay at the outset. The committee recommends that the rate of the tax refund gradually be reduced to zero to ensure treatment similar that accorded the buyers of new residential dwellings.

TABLE 22

Mesures to be abolished – Consumption taxes

Measure	Number of beneficiaries in 2011	Financial impact for the government (millions of dollars)
1. Refund in respect of automatic door openers for use by persons with a disability	n/a	—
2. Exemption accorded to the Société Saint-Jean-Baptiste de Montréal	n/a	—
3. Reduction in the rate of the specific tax applicable to beer sold by microbreweries and the tax on alcoholic beverages sold by small-scale producers	101	16
4. Zero-rating of children's diapers and breast-feeding items	n/a	14
5. Zero-rating of books[1]	n/a	—
6. Tax refund granted to the purchasers of new homes	28 100	132
7. Tax refund granted to the lessors of new residential apartment buildings	3 000	35
TOTAL	—	**197**

n/a: The number or cost is unavailable because of insufficient or missing data.
(1) The amounts generated would be allocated to budget measures.

❑ Tighten the application parameters of certain tax expenditures

The committee recommends that the application parameters of five tax expenditures related to consumption taxes be tightened.

■ Refund measures related to the implementation of the QST

The committee recommends that the parameters of certain existing tax refund measures related to the implementation of the QST be tightened:

— certain tax refund measures granted to organizations such as charitable organizations, non-profit organizations, schools, colleges, universities, hospitals and municipalities to neutralize the impact of the implementation in 1992 of the QST that are still in force:

  — tax refund granted to charitable organizations and certain non-profit organizations (50% rate);

  — tax refund granted to schools, colleges and universities (47% rate);

  — tax refund granted to hospitals (51.5% rate);

  — tax refund granted to municipalities (50% rate).

The committee recommends that the rate of the tax refund granted to the designated organizations gradually be reduced to zero. The organizations affected should be fully compensated through budgetary transfers. This recommendation does not generate any funds for the tax reform.

■ A measure related to the fuel tax

The committee recommends the tightening of the parameters of a rate reduction measure in respect of the fuel tax:

— a reduction in the rate of the fuel tax in respect of aircraft.

The reduction should be decreased by 1 cent following Ontario's decision to increase by 4 cents the rate of the tax applicable in its territory. The rate applicable in Québec would thus remain competitive.

TABLE 23

Measures to be tightened – Consumption taxes

Measure	Number of beneficiaries in 2012	Financial impact for the government (millions of dollars)
1. Tax refund granted to charitable organizations and certain non-profit organization	14 100	—
2. Tax refund granted to schools, colleges and universities	370	—
3. Tax refund granted to hospitals	140	—
4. Tax refund granted to the municipalities	1 100	—
5. Reduction in the rate of the fuel tax in respect of aircraft	n/a	4.5
TOTAL		**4.5**

n/a: The number or cost is unavailable because of insufficient or missing data.

❑ Maintain the status quo as regards other tax measures

The committee recommends that the status quo be maintained in respect of 32 tax measures concerning consumption taxes.

■ Measures that recognize specific products or services

The committee recommends that the status quo be maintained concerning measures that recognize specific products or services:

— zero-rating of prescription drugs;

— zero-rating of medical devices;

— exemption of educational services;

— exemption of childcare services and personal care services;

— exemption of common municipal services;

— exemption of municipal mass transit services;

— exemption of supplies granted to charitable organizations and non-profit organizations;

— streamlining measures pertaining to the convention sector;

— exemption of health services;

— exemption of ferries, roads and toll bridges, which are subject to user fees;

— exemption in respect of the individual insurance of persons;

— exemption in respect of certain compulsory insurance plans, i.e. public plans.

- **Measures geared to administrative simplification**

The committee recommends that the status quo be maintained concerning measures intended to simplify the administration of the QST for certain organizations:

— the simplified method for charitable organizations;

— the quick method for small businesses;

— the quick method for eligible public service organizations;

— the simplified input tax rebate calculation method;

It should be noted that the simplified method to calculate partial QST refunds for eligible public service organizations should be abolished, in accordance with the committee's recommendation presented earlier to abolish tax refunds granted to public bodies.

— the exclusion of small suppliers from the scope of application of the QST.

The current threshold of $30 000 should be raised but simultaneously with the threshold that the federal government applies with regard to the GST.

- **Measures required for harmonization**

The committee recommends that the status quo be maintained in the case of measures that must be harmonized with the federal tax scheme:

— exemption of residential rents;

— exemption (zero-rating) of financial services;

— non-taxable imports;

— specific treatment of entertainment expenses.

- **Measures that recognize the use of fuel as an input**

The committee recommends that the status quo be maintained concerning exemption or refund measures pertaining to the fuel tax that recognize the use of fuel as a business input:

— the exemptions and refunds granted to farmers and fishermen;

— the refund granted to farming enterprises, forest-dependent businesses and mining ventures concerning off-road vehicles;

— the exemptions and refunds granted to the industrial sector.

■ Measures favourable to the environment as regards the fuel tax

The committee recommends that the status quo be maintained with respect to certain measures favourable to the environment as regards the fuel tax:

— the exemption for propane gas;

— the refund granted to mass transit services;

— the refund in respect of biodiesel.

■ Measures aimed at protecting certain sectors in the face of international competition or avoiding the shifting of economic activities

The committee recommends that the status quo be maintained in respect of measures aimed at protecting certain sectors in the face of international competition or avoiding the shifting of economic activities:

— the exemption and the refund of the fuel tax granted to the aviation sector;

— the exemption and the refund of the fuel tax granted to commercial vessels.

■ Other measures

The committee also recommends that the status quo be maintained for other measures for various reasons:

— the exemption of sales of used apartment buildings or buildings for personal use;

This exemption seeks to avoid the tax cascading of the QST that would run counter to the principle that underpins a value-added tax.

— the refund granted to employees and associates;

The measure ensures coherence between an employee and a self-employed worker in respect of certain expenses.

— the refund in respect of fuel used to run a motor for non-propulsive purposes in vehicle equipment.

The refund reflects the principle that underpins the fuel tax, which is essentially to subject products used to operate propulsive engines.

TABLE 24

Measures that must remain unchanged – Consumption taxes

Measure	Number of beneficiaries in 2012	Cost (millions of dollars)
1. Zero-rating of prescription drugs	n/a	351
2. Zero-rating of medical devices	n/a	74
3. Exemption of educational services	n/a	116
4. Exemption of childcare services and personal care services	n/a	130
5. Exemption of common municipal services	n/a	99
6. Exemption of municipal mass transit services	n/a	82
7. Exemption of supplies granted to charitable organizations and non-profit organizations	n/a	n/a
8. Streamlining measures pertaining to the convention sector	n/a	f
9. Exemption of health services	n/a	296
10. Exemption of ferries, roads and toll bridges	n/a	4
11. Exclusion of small suppliers from the scope of application of the QST	298 000	138
12. Exemption of residential rents	n/a	611
13. Exemption (zero-rating) of financial services	n/a	148
14. Non-taxable imports	n/a	n/a
15. Specific treatment of entertainment expenses	332 000	29
16. Exemption in respect of the individual insurance of persons	n/a	392
17. Exemption in respect of certain compulsory insurance plans, i.e. public plans	n/a	n/a
18. Simplified methods for charitable organizations	880	4
19. Quick method for small businesses	9 000	f
20. Quick method for eligible public service organizations	90	f
21. Simplified input tax rebate calculation method	n/a	n/a

TABLE 24

Measures that must remain unchanged – Consumption taxes (continued)

Measure	Number of beneficiaries in 2012	Cost (millions of dollars)
22. Exemption and refund of the fuel tax granted to farmers and fishermen	n/a	f
23. Refund of the fuel tax granted to farming enterprises, forest-dependent businesses and mining ventures concerning off-road vehicles	n/a	26
24. Exemptions and refunds of the fuel tax granted to the industrial sector	n/a	n/a
25. Refund of the fuel tax in respect of fuel used to run a motor for non-propulsive purposes in vehicle equipment	n/a	18
26. Exemption of the fuel tax in respect of propane	n/a	n/a
27. Refund of the fuel tax granted to public transit services	n/a	24
28. Refund of the fuel in respect of biodiesel	n/a	f
29. Exemption and refund of the fuel tax granted to the aviation sector	n/a	n/a
30. Exemption and refund of the fuel tax granted to commercial vessels	n/a	n/a
31. Exemption of sales of used apartment buildings or buildings for personal use	n/a	n/a
32. Refund granted to employees and associates	n/a	24
TOTAL		**2 566**

f: The fiscal cost is less than $2 million.
n/a: The number of beneficiaries and the financial impact are unavailable because of insufficient or missing data.

3.2 Measures concerning certain specific tax expenditures

Certain specific tax measures pertaining to more complex fiscal concepts or that require fuller explanations are presented in detail below:

— fuel tax reduction measures in certain regions;

— zero-rating of basic foodstuffs;

❑ Fuel tax reduction measures in certain regions

The government has granted fuel tax reductions since 1982 in border areas and since 1985 in remote areas.

— The reduction is offered in remote areas because of transportation costs.

  Since 1995, the owners of passenger vehicles in remote areas have also benefited from a reduction in motor vehicle registration fees to offset transportation costs.

— In border areas, the reduction is offered to ensure that the competitive position of Québec gasoline retailers in the regions in relation to their competitors in neighbouring jurisdictions is not affected by Québec's taxation of gasoline.

  Lower gasoline prices in neighbouring jurisdictions is attributable essentially to lower taxation of the product.

The committee has noted, with respect to transportation costs, an additional deduction for the application of income tax was granted to manufacturing SMEs in Budget 2014-2015 to mitigate the handicap for the enterprises concerned.

On the other hand, gasoline retailers in border areas are still facing competition because of differences with neighbouring jurisdictions.

■ The elimination of the fuel tax reduction for remote areas

The committee recommends:

— the elimination of the fuel tax reduction for remote areas;

— the maintenance of the reduction for border areas;

— the maintenance of the reduction in motor vehicle registration fees for border areas.

The elimination of the reduction for remote areas would also simplify the taxation system by reducing the number of rates applicable to the fuel tax.

❑ Zero-rating of basic foodstuffs

At present, most food sold in grocery stores and convenience stores is deemed to be zero-rated basic foodstuffs. Most countries in the European Union, except for the United Kingdom and Ireland, in particular, levy a form of taxation on foodstuffs, often at a lower rate.

It should be noted that the complete zero-rating of food, while it is intended at first sight to ensure that the most disadvantaged are able to satisfy their basic needs, benefits high-income taxpayers more.

■ Reflection on revision of the existing zero-rating

The committee recommends contemplating in the medium term:

— broadening the list of taxable foodstuffs;

— levying a reduced rate on other products that are now zero-rated, for example equivalent to 4%.

Such reflection focuses on the medium term since changes cannot be implemented before 2018 because of the existing harmonization agreement with the federal government.

The change should be accompanied by a corresponding adjustment in the solidarity tax credit to ensure that the most disadvantaged are not penalized.

■ Zero-rating of harmful food products

The committee also recommends examining the feasibility of relying on taxation to reduce the consumption of certain food products that are harmful to health, including sweetened beverages.

It should be noted that there is limited empirical proof of the existence of a link between such taxation and the fight against obesity and the diseases that stem from it. The committee nevertheless perceives the levying of such a tax as a signal of the importance accorded the problem.

The amounts generated should be reinvested in the fight against obesity in order to have a genuine impact. Education and awareness-raising in the schools or general information measures such as clear indications of calorie counts and the nutritional value of food in restaurants come to mind.

4. COLLECTION OF TAXES RELATED TO E-COMMERCE

The generalization of the Internet has spawned a veritable revolution in trade relations with the introduction and development of e-commerce.

From a fiscal standpoint, the development of e-commerce has engendered major problems as regards the collection of sales tax and income tax.

Taxation authorities are having considerable difficulty applying taxation rules to electronic trade transactions when such transactions are performed by a supplier outside the territory that the authorities control. The new technologies now make it possible to do business in Québec and maintain a strong economic presence there without owning a stable establishment or operating a business and, therefore, without being subject to income tax.

This problem is not specific to Québec and affects all jurisdictions.

❑ Collection of the sales tax

The problem of the collection of sales tax is now well known.

■ An estimate of tax losses

In the case of Québec, Revenu Québec estimated in 2012 at $165 million the tax losses sustained by the Québec government because of online purchases made by Quebecers from suppliers established outside Canada.

It is difficult to estimate the losses stemming from online purchases that Quebecers make from suppliers in other provinces but the amount is undoubtedly significant. Revenu Québec has advanced a figure of $300 million.

Such estimates must be considered cautiously since little data is available on e-commerce.

These figures certainly give an idea of the scope of the problem, if only because of the extremely rapid growth of e-commerce.

■ We urgently need to act

The committee wishes to emphasize that the tax losses that the Québec government has already sustained are considerable and can only increase in the future if the problem of collecting sales tax on e-commerce transactions is not resolved.

We therefore urgently need to act, but the initiatives to be taken are not easy to define and implement.

■ The current situation: no specific rule governing e-commerce

In Québec as in the rest of Canada, there are no specific rules concerning e-commerce in current legislation governing the Québec sales tax (QST), the federal goods and services tax and the harmonized sales tax (GST/HST).

E-commerce transactions are thus subject to the general QST and GST/HST rules and to existing taxing statutes.

■ The source of the difficulties

The problem stems from the impossibility for Québec and for Canada to force suppliers to register when they are located outside their control area and they maintain neither a physical nor a significant presence in the territory.

For Québec, problems regarding the collection of QST concern both the transactions conducted by suppliers from the rest of Canada and those involving suppliers from foreign countries.

■ An observation: there is no simple solution

The problem raised by the application of existing tax rules governing e-commerce is significant and complex and the committee has observed that there is no simple solution.

▪ Transactions conducted by suppliers located in the rest of Canada

As for online transactions carried out by suppliers located in the rest of Canada, it should be possible to partly remedy the current situation if the federal government agrees to collaborate with the Québec government for this purpose.

The committee recommends that the Québec government initiate discussions to obtain the federal government's consent to administer, on Québec's behalf, the registrations that would become compulsory under the QST regime for businesses located outside Québec that make supplies to Québec without maintaining there a physical or significant presence.

▪ Transactions conducted by suppliers from foreign countries

In the case of online transactions carried out by suppliers from foreign countries, the problem of the collection of sales taxes is on the agenda in the OECD's deliberations. The fiscal challenges linked to the digital economy are at the forefront of ongoing discussions between the main developed countries.[51]

The committee recommends that the Québec government put pressure on the federal government so that it steps up its efforts within the framework of ongoing OECD deliberations.

A federal government consultation on the international tax planning of multinational companies

In its 2014 budget, the Government of Canada announced a consultation process on the international tax planning conducted by multinational companies.

Among the questions proposed, the government invited the interveners to make known their opinions on the measures the government should adopt to ensure the effective collection of sales taxes on online sales to Canadians concluded by vendors located abroad.

More specifically, the government wondered whether it should proceed as other countries have done and demand that vendors located abroad register and collect the local tax. The consultations ran from February 11 to June 11, 2014.

According to the study commissioned by the committee entitled *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation*:

> "certain respondents appear to support this approach in particular as regards sales conducted by non-residents to non-registered buyers bearing in mind that this would put foreign and Canadian operators on an equal footing while non-residents now benefit from a competitive advantage insofar as non-registered buyers very rarely self-assess the GST/HST on their purchases." [1] [OUR TRANSLATION]

1 *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation.*

51 OECD, *Action Plan on Base Erosion and Profit Shifting*, July 19, 2013.

- **The feasibility of other initiatives**

The committee wonders about the feasibility of other initiatives such as:

— imposing responsibility for collecting and remitting sales taxes on financial payment institutions through which all digital transactions are conducted;

— encouraging foreign businesses to levy the sales taxes on goods and services sold in Canada and in Québec to maintain their image as corporate citizens (voluntary mandataries) by facilitating their task from an administrative standpoint;

— signing a number of cross-border agreements with other jurisdictions to share information.

The committee is of the opinion that the Québec government should assume leadership in this regard among the Canadian provinces.

❑ Collection of corporate income tax

In the case of the collection of corporate income tax, the problem is directly tied to the notion of a permanent establishment and the problem exists at the interprovincial and international levels.

The OECD is proposing several possible solutions in order, in particular, to modify the definition of a permanent establishment by adding to it a significant digital presence.

In the case of the collection of sales taxes on online transactions conducted by suppliers from foreign countries, the committee recommends that the Québec government pressure the federal government to step up its efforts within the framework of the OECD's ongoing deliberations.

PART 4:
USER FEES

The committee's recommendations concerning user fees are presented in two sections devoted to:

— reduced-contribution childcare services user fees;

— Hydro-Québec's rates.

1. REDUCED-CONTRIBUTION CHILDCARE SERVICES USER FEES

In the context of its deliberations, the Québec Taxation Review Committee had a mandate to assess the possibility of subjecting to taxation certain user fees in order to take into account the ability to pay of the users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

Setting user fees for childcare services falls specifically within the scope of the mandate.

The committee successively examined:

— the fiscalization of a single rate in the case of reduced-contribution childcare services;

— the case of school childcare services.

❑ A recommendation that precedes the announcement of the changes adopted by the government

At the request of the Minister of Finance, the committee established its recommendation concerning user fees for reduced-contribution childcare services before the government announced changes in this respect in November 2014.[52]

The following section summarizes the committee's analysis and recommendation by taking as its starting point the single $7.30 per day rate and not the new funding method that the government has since announced.

The changes that the government adopted differ from the committee's recommendation. However, the committee wishes to maintain its recommendation.

It believes that the fee-setting method that the government announced in November 2014 and that is to apply in the short term could mark the first step in the direction of the method that it is proposing. Indeed, it should be noted that the committee's proposal still represents a saving for families.

Moreover, the government could generate $101 million in additional savings in relation to the new funding method that it announced.

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[52] The committee's advisory opinion was submitted to the Minister of Finance at his request on November 18, 2014. See Volume 4 of this report for the unabridged version of the opinion.

1.1 The fiscalization of a single rate

The committee recommends the revision of the method of funding reduced-contribution childcare services through the fiscalization of a single rate. The revision is intended, above all, to ensure the long-term survival of the reduced-contribution childcare services network.

The committee has thus ensured in the definition of its proposal that it is not raising the cost of childcare services for most families in relation to funding at $7.30 per day and even that it is reducing it for low- or middle-income households.

The committee is not calling into question the foundation of the network but is advocating the revision of its funding method.

■ Reduced costs for families

The revision of funding for childcare services would reduce the net cost of childcare spaces for families with incomes under roughly $110 000.

— Since the median income of single-parent families is $30 800, most of them would pay a lower net daily childcare cost. On annual income of $120 000, the increase in the net cost of childcare would be barely $0.61 per day.

— The median family income of two-parent families is $81 800, a level of income in respect of which the net rate is lower than it is now. On annual family income of $120 000, the increase in the net cost of childcare would be only $1.04 per day.

■ Savings for the government

The proposed revision would also generate for the Québec government an additional annual saving of $263 million through:[53]

— a $114-million increase in the net cost for families according to income;

— a bigger contribution from the federal government stemming from the application of the child care expense deduction and its impact on certain socio-fiscal transfers, which would represent $149 million annually.[54]

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[53] When account is taken of the rate changes that the government proposed in the December 2014 *Update on Québec's Economic and Financial Situation*, a net saving of $101 million could be achieved beyond the saving announced.

[54] This includes the measures that the federal government announced on October 30, 2014: income-splitting for families, the enhancement from $100 to $160 per child under 6 years of age of the monthly Universal Child Care Benefit payment, and the increase from $7 000 to $8 000 in the ceiling on the child care expense deduction for such families.

■ The net cost for families

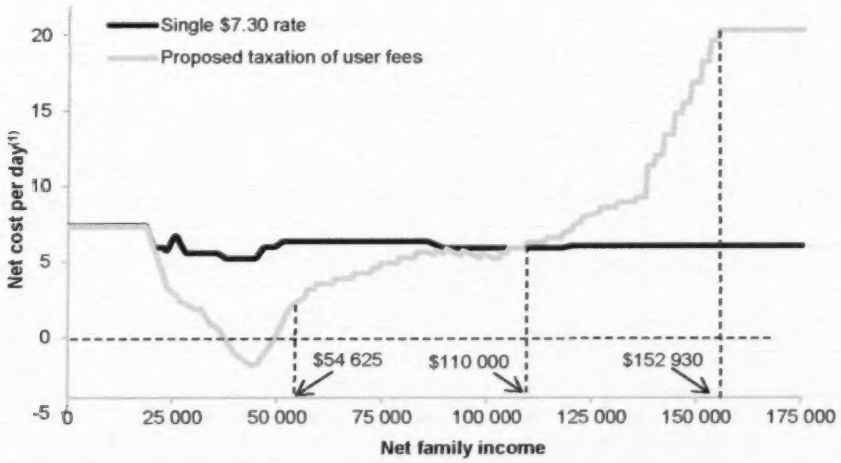
The chart below illustrates the net cost according to family income for a family with one child and two equal incomes.

The net cost is initially fixed then falls from net income of roughly $20 000, since the federal deduction has no impact when there is no tax payable.

On a family income of roughly $40 000 per year, the net cost rises gradually according to income but remains below the cost at the $7.30 per day rate up to a family income of roughly $110 000, at which point the two curves cross.

CHART 10

Illustration of the net cost per day under a single $7.30 rate and according to the proposed fiscalized rate for a couple with one child and two equal incomes – 2015
($)



(1) Including federal taxation.

■ Details of the proposed fiscalization

The scenario that the committee is proposing sets the gross rate before tax compensation at $35 and renders it eligible for the Québec refundable tax credit for childcare expenses, which would be enhanced. The rate would subsequently be indexed annually.

The rate is not the real cost that families bear since they would benefit from assistance from the Québec and federal governments.

— The rate of the Québec tax credit for childcare expenses would be raised from 75% to 80% for low-income families and maintained at that level up to family income of $54 625.

— The rate would entitle the taxpayer to the maximum amount of the federal government's deduction for childcare expenses.

The subsidy that the government pays organizations offering such services would, on the other hand, be reduced to maintain the current level of funding of a space in reduced-contribution childcare services.

■ Additional benefits

In addition to the benefits already mentioned, this scenario would reduce the cost of childcare services for low- and medium-income families that do not have access to spaces in the subsidized network.

Indeed, the enhancement of the refundable tax credit for childcare expenses would apply both to families that rely on the subsidized network and those that resort to the non-subsidized network.

In the same way, the scenario would establish broader neutrality between the subsidized and non-subsidized networks. Without fiscalization, the application of the single rate creates situations in which certain families bear a cost per subsidized space higher than the cost of a non-subsidized space because of the tax benefits linked to non-subsidized spaces. In other instances, a non-subsidized space may have a net cost that is significantly higher than a subsidized space despite the applicable tax benefits. Through the proposed fiscalization, the net cost of a $35 space in the non-subsidized network becomes equivalent to that of a subsidized space.

Furthermore, the scenario would not have a significant negative impact on the problem of high implicit marginal tax rates. Indeed, the committee has ensured a slow reduction of the rate of the credit according to income, especially in the income field most affected by the problem of high implicit marginal tax rates.

■ Recognize the limited cash resources of certain families

However, the implementation of this scenario requires recognition of the impact for families of having to finance at the outset the higher gross rate, which can pose a problem of cash resources for a number of them.

The committee has noted that families whose children attend non-subsidized day care centres are already experiencing this situation.

Québec has established a monthly advance payment system for the tax credit for childcare expenses. The system should be adapted to satisfy a growing number of beneficiaries of the tax credit to ensure that all families affected by the change may take advantage of it as soon as it comes into force.

1.2 School childcare services

Revision of the funding formula that the committee is proposing with respect to reduced-contribution childcare services cannot be applied directly to school childcare services.

— the cost of space is considerably lower because of the much different nature of the service offered;

— the parents already assume a bigger share.

The committee recommends the application of a revision concerning the principle of fiscalization, but adapted to the specific nature of school childcare services.

— The full rate of $12.73 would be demanded of parents.

— A new tax credit modeled on the proposed tax credit for preschool childcare services would be granted in respect of such fees in order to reduce their cost.

The parameters of the new tax credit would, however, be adjusted so that the parental contribution is adjusted according to income, but at zero cost to the government and families overall.

■ Protection of low- or middle-income families

As is the case under the scenario for reduced-contribution childcare services, families whose family income falls below roughly $110 000 would only pay more under the $7.30 per day rate and many of them would pay a lower net cost. For families with incomes of more than $110 000, the net cost would increase according to income.

Accordingly, low- or middle-income families would benefit from a lower net cost while the cost would only increase for those with higher incomes.

2. HYDRO-QUÉBEC'S RATES

Québec benefits from electricity rates that are lower than in most other jurisdictions. The low rates are advantageous for consumers.

They nonetheless imply lower revenues for the government, which is Hydro-Québec's sole shareholder, in addition to failing to encourage reduced consumption.

The committee has formulated two recommendations concerning electricity rates in Québec that generate additional revenues:

— a 0.8-cent-per-kilowatt-hour increase in the cost of heritage pool electricity;

— the levying of a tax on overconsumption of household electricity;

— longer-term reflection on time-sensitive electricity rates.

2.1 A 0.8-cent-per-kilowatt-hour increase in the cost of heritage pool electricity

The cost of heritage pool electricity set by the government is used to calculate the electricity rates that consumers pay. The price is now indexed annually and the value of the indexation is paid into the Generations Fund.

❑ Increase in the cost of heritage pool electricity

The committee recommends that the cost heritage pool electricity be increased by 0.8 cent per kilowatt-hour over two years and that its indexation be maintained thereafter.

The additional revenues generated by the increase would fund the committee's proposed tax reform by using the funds generated for individuals and corporations, respectively.

The revenues stemming from the indexation would continue to be paid into the Generations Fund.

This measure would generate total annual revenues of $1.123 billion:

— $623 million among individual consumers;

— $500 million among corporations.

❑ Impact of the measure

In the past, large industrial customers paying the L rate were not subject to the indexation of the cost of heritage pool electricity. Assuming that such customers are also exempt from the proposed increase, the average rate increase would stand at roughly 1.0 cent per kilowatt-hour (kWh) for the other customers overall.

In the long run, the measure would have a limited impact on household customers. The annual increase stemming from the implementation of this measure is estimated at:

— $108 for a five-and-a-half-room dwelling unit;

— $196 for a small house;

— $257 for an average-sized house;

— $482 for a big house.

TABLE 25

Impact of the 0.8-cent-per-kilowatt-hour increase in the cost of heritage pool electricity – Residential clientele

	Average price (¢/kWh)		Average annual bill ($)			
					Difference	
Type of dwelling[1]	Before the recommendation	After the recommendation	Before the recommendation	After the recommendation	In $	As a %
Five-and-a-half-room dwelling unit	7.37	8.33	854	962	108	12.6%
Small house	7.60	8.59	1 557	1 753	196	12.6%
Average-sized house	7.71	8.71	2 042	2 299	257	12.6%
Big house	7.96	8.99	3 824	4 306	482	12.6%

(1) According to the typical cases presented in Hydro-Québec's 2015-2016 rate application.
Source: Hydro-Québec estimates.

2.2 Levying a tax on overconsumption of household electricity

The low cost of electricity in Québec hardly encourages energy conservation and better control over consumption.

The household rate (D rate) comprises:

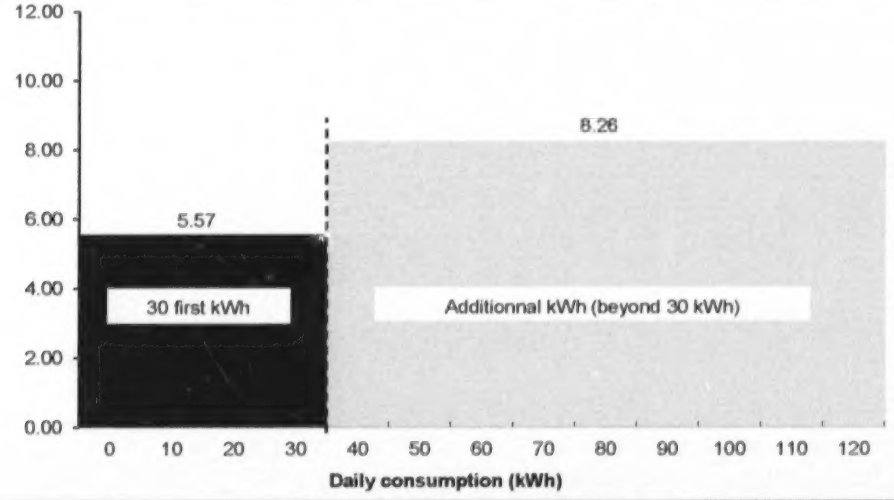
— a daily charge of 40.64 cents, payable independently of electricity consumption;

— a first electricity pricing level of 5.57 cents per kilowatt-hour applicable to the first 30 kilowatt-hours consumed daily;[55]

— a second pricing level of 8.26 cents per kilowatt-hour applicable to daily electricity consumption exceeding the first 30 kilowatt-hours.

CHART 11

Structure of the household electricity rate
(in cents per kWh)



Note: The rate in effect on April 1, 2014, to which is added the daily charge of 40.64 cents.

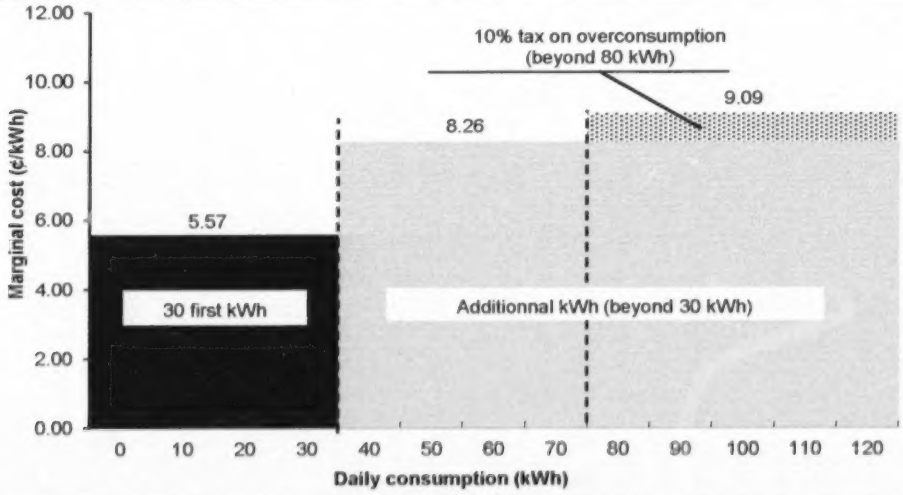
[55] Calculated on a daily average over a two-month billing cycle.

❑ Levying a 10% tax on overconsumption of electricity

The committee recommends that a 10% tax be levied on overconsumption of average household electricity exceeding 80 kilowatt-hours per day, which would raise the cost of consumption from 8.26¢/kWh to 9.09 ¢/kWh for this consumption bracket. The tax would be added to Hydro-Québec's rate and would not be a new rate.

CHART 12

Structure of the household electricity rate – With the 10% overconsumption tax
(in cents per kWh)



Note: The rate in effect on April 1, 2014, to which is added the daily charge of 40.64 cents.

❑ Impact of the measure

The tax would affect the household consumers who consume the most electricity. By way of an example, it would not affect individuals living in a five-and-a-half-room dwelling unit. For bigger dwellings, the annual impact of the tax would be:

— $8 for a small house;

— $36 for an average-sized house;

— $182 for a big house.

The measure would generate $82 million annually.

TABLE 26

Impact of levying a 10% tax on overconsumption of electricity – Residential customers

	Average price (¢/kWh)		Average annual bill ($)			
					Difference	
Type of dwelling[1]	Before the recommendation	After the recommendation	Before the recommendation	After the recommendation	In $	As a %
Five-and-a-half-room dwelling unit	7.37	7.37	854	854	—	—
Small house	7.60	7.64	1 557	1 565	8	0.5%
Average-sized house	7.71	7.85	2 042	2 078	36	1.8%
Big house	7.96	8.34	3 824	4 006	182	4.8%

(1) According to the typical cases presented in Hydro-Québec's 2015-2016 rate application.
Source: Hydro-Québec estimates.

The household electricity rate

Existing structure

At present, household electricity consumers pay a daily fixed charge of 40.64¢. The next 30 kWh per day are then billed at 5.57¢/kWh and the remaining energy is billed at 8.26¢/kWh.

Impact of the proposed changes

All told, for household customers, the combination of the tax on overconsumption and the impact of the higher cost of heritage pool electricity would increase the average annual electricity bill by:

- $108 for a five-and-a-half-room dwelling unit;
- $204 for a small house;
- $293 for an average-sized house;
- $664 for a big house.

Summary of the proposed measures for residential customers

	Average price (¢/kWh)		Average annual bill ($)			
					Difference	
Type of dwelling[1]	Before the recommendation	After the recommendation	Before the recommendation	After the recommendation	In $	As a %
Five-and-a-half-room dwelling unit	7.37	8.33	854	962	108	12.6%
Small house	7.60	8.63	1 557	1 761	204	13.1%
Average-sized house	7.71	8.85	2 042	2 335	293	14.4%
Big house	7.96	9.37	3 824	4 488	664	17.4%

(1) According to the typical cases presented in Hydro-Québec's 2015-2016 rate application.
Source: Hydro-Québec estimates.

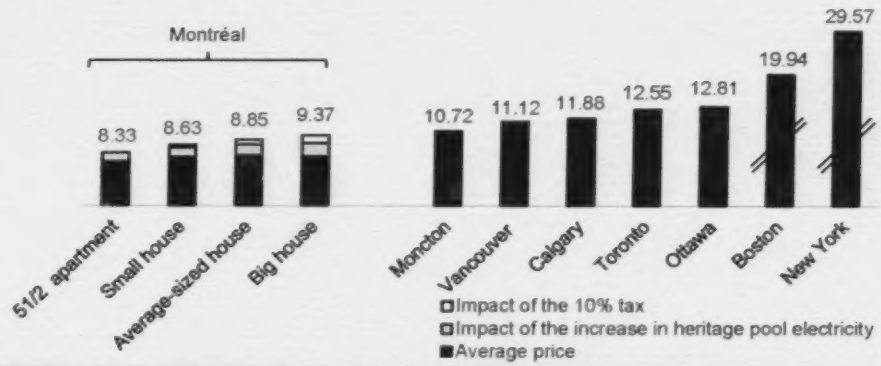
The household electricity rate (continued)

Despite the two proposed measures, the household rate remains competitive

By combining the two measures concerning the residential sector that the committee is proposing, the price of electricity in Québec would remain lower than elsewhere.

Despite the measures, average household electricity prices in Montréal are the lowest. For example, after the application of the measures, the average price of electricity for a big house in Montréal will be 9.37¢/kWh, compared with 12.81¢/kWh in Ottawa.

Average household electricity prices in Montréal (after the recommendations) and in certain big North American cities
(in ¢/kWh)



Note: The changes are based on annual consumption by type of dwelling: 11 590 kWh for a five-and-a-half-room dwelling unit (966 kWh per month), 20 494 kWh for a small house (1 708 kWh per month), 26 484 kWh for an average-sized house (2 207 kWh per month), and 48 062 kWh for a big house (4 005 kWh per month).

2.3 Longer-term reflection on time-sensitive electricity rates

Electricity rates that vary depending on the time of day are a worthwhile avenue to explore.

Time-of-use rates vary the cost of the electricity consumed according to the time of day. Accordingly, during peak periods, the price increases to reflect higher electricity generation and distribution costs.

Such rates would allow for more efficient use of Québec's electrical resources by encouraging consumers to better spread out consumption during the day in order to achieve savings. On the other hand, the distributor would generate savings by satisfying more stable demand and reducing peak period demand.

PART 5:
TAX ADMINISTRATION

The committee's recommendations concerning tax administration are presented in two sections devoted to:

— the fight against tax evasion, tax avoidance and aggressive tax planning schemes;

— better oversight of provisions respecting trusts.

1. THE FIGHT AGAINST TAX EVASION, TAX AVOIDANCE AND AGGRESSIVE TAX PLANNING SCHEMES

Tax evasion and tax avoidance refer to an array of initiatives that certain individual and corporate taxpayers undertake to reduce the amount of tax payable.[56]

Tax evasion indicates the behaviour of an individual or a corporation that deliberately makes false or misleading declarations, fails to comply with a taxing statute, attempts to evade tax or to obtain a refund to which the individual or the corporation is not entitled.

Tax avoidance is a form of planning that does not contravene any specific rule in the statute but does not comply with the intent and spirit of the law.

Certain tax planning schemes border on tax avoidance. To respond to such schemes, Québec has defined the concept of "aggressive tax planning."[57]

Aggressive tax planning schemes reduce tax without its being possible to determine at first sight whether or not the reduction abides by the intent and the spirit of the law. Aggressive tax planning schemes are often complex operations that encompass several stages and rely on sophisticated mechanisms.

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[56] See: Ministère des Finances du Québec, *Un portrait général du régime fiscal au Québec*, information document prepared at the request of the Québec Taxation Review Committee, September 2014, page 65.

[57] Revenu Québec uses the expression "abusive tax planning."

1.1 Different challenges depending on the territory

For Québec, the fight against tax evasion and the responses to tax avoidance differ considerably depending on whether reference is made to activities directly linked to Québec's territory and subject to Québec statutes, or interprovincial or international activities.

❑ In Québec's territory

In Québec's territory and more generally speaking in the fields under its jurisdiction, the Québec government has assigned to Revenu Québec a mandate to combat tax evasion, tax avoidance and aggressive tax planning schemes.

To this end, the government has granted Revenu Québec significant means and powers to intervene accompanied by demanding objectives respecting the tax revenues to be recovered.

Bearing in mind the initiatives already undertaken, the committee recommends that Québec pursue the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Major, innovative initiatives

Revenu Québec has implemented several major, innovative initiatives that have enabled the Québec government to recover a significant portion of the amounts due.

The fight against tax evasion

Revenu Québec has launched several initiatives to effectively combat tax evasion. In particular, mention should be made of:

- the introduction of sales recording modules in the food service industry;
- Revenu Québec's sustained presence on major public and private construction sites;
- the introduction of the Ministère du Revenu certificate for public construction contracts;
- the wealth indicators project.

The fight against tax avoidance and aggressive tax planning schemes

Québec has also been very proactive in the realm of tax avoidance with respect to control of aggressive tax planning schemes.

It has implemented compliance assessment tools such as compulsory preventive disclosures, information requests concerning trusts and extensions of the period of limitation under certain circumstances.

Québec was the first jurisdiction in Canada to establish rules aimed at combating aggressive tax planning schemes, which has enabled it to participate in the effort undertaken by tax administrations in the developed countries to promote integrity in the fight against tax avoidance and aggressive tax planning schemes.

The Government of Canada subsequently introduced rules governing the disclosure of avoidance operations.

Québec's efforts have paid off. A number of aggressive tax planning schemes have been identified and some of them have been curtailed.

Despite such efforts, taxpayers continue to resort to aggressive tax planning schemes to avoid tax.

❑ At the interprovincial level

Revenu Québec is focusing, in particular, on the fight against tax avoidance and, more specifically, against aggressive tax planning schemes.

Despite progress in this respect, taxpayers continue to resort to undesirable tax planning schemes.[58]

To counteract such schemes, cooperation between the provinces is essential. It is hard for Québec to act alone. It must, ideally, avoid possible double taxation.

The committee recommends that the Québec government step up discussions with the other provinces and the federal government in order to further promote collaboration between the different jurisdictions.

In practical terms, this question should be put on the agenda of interprovincial or federal-provincial meetings, for example within the framework of the finance ministers' conferences or the Council of the Federation.

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[58] See Gilles N. Larin, Lyne Latulippe and Marwah Rizqy,in collaboration with Carmina Chan, *La fiscalité internationale et interprovinciale au Québec*, study produced for the Québec Taxation Review Committee, Research Chair in Taxation and Public Finance, Université de Sherbrooke, November 20, 2014, in Volume 5 of this report, pages 97-98.

❑ At the international level

At the international level, the fight against tax evasion, tax avoidance and aggressive tax planning schemes is of a different order. Tax evasion and tax avoidance raise major, highly complex challenges.

The jurisdictions commonly called tax havens are characterized by rules that guarantee secrecy to depositors. Such secrecy is usually linked to fraudulent manœuvres in relation to the depositor's country of origin.

■ Considerable financial challenges

The questions of tax avoidance and aggressive tax planning schemes also arise at the international level with respect to other questions, such as those related to:

— intellectual property;

— hybrid corporations;

— transfer pricing.

These complex questions raise considerable financial challenges.

Tax havens
A State is deemed to be a tax haven when it satisfies several conditions. – Taxes are non-existent or very low. – Very strict laws protect banking secrecy. – The administration of the taxation system lacks transparency. – There is no genuine collaboration as regards information exchanges with other countries. In 2000, the OECD published a list of 35 countries deemed to be tax havens. In order to be withdrawn from the list, the countries had to agree to modify their ways of doing business.

An international priority

The developed countries have gradually become aware of these challenges such that the fight against tax evasion, tax avoidance and aggressive tax planning schemes is now deemed to be a priority in international discussions and negotiations.

This vigorous international effort coincides with growing public awareness. In the developed countries, citizens are increasingly reluctant to accept the unfairness of the tax burden stemming from tax evasion, tax avoidance and aggressive tax planning schemes.

Responses

In point of fact, the fight against tax evasion, tax avoidance and aggressive tax planning schemes at the international level is mainly waged by federal tax authorities.

Québec is poorly equipped to singlehandedly fight tax evasion, tax avoidance and aggressive tax planning schemes at the international level.

Facilitate information exchanges

The first way to fight against tax evasion, tax avoidance and aggressive tax planning schemes at the international level is to facilitate information exchanges between tax administrations.

International action in respect of transfer pricing

A second tool to combat tax evasion, tax avoidance and aggressive tax planning schemes is international action in respect of transfer pricing.

The committee believes that the Québec government must clearly indicate its concern about the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Québec should vigorously support international efforts in this respect.

The committee recommends that Québec establish a centre of expertise devoted to the three problems. Such an initiative is one means of playing a leading role in the fight.

The committee also recommends that the federal government be asked to inform the provinces and the public of the extent of the problem and the solutions that it is implementing or intends to implement.

1.2 Tax audits

The question of tax evasion and tax avoidance led the committee to broach the problem of tax audits. The committee has observed that Revenu Québec's initiatives raise questions and criticism from the taxpayers concerned.

Faced with these questions and criticisms, the committee nonetheless wishes to point out the importance of according Revenu Québec all of the means necessary to fight against tax evasion, tax avoidance and aggressive tax planning schemes.

The committee recommends that simple initiatives be implemented to ensure better follow-up to the processing of taxpayers' files during an audit.

— The committee is referring, in particular, to the numbering of proposed assessments, which would make it possible to more readily track the advancement of taxpayers' files.

— The committee also recommends that the government evaluate the establishment of a dispute settlement mechanism.

— Furthermore, an evaluation of customer service should be conducted after each audit.

— Lastly, Revenu Québec should maintain public statistics concerning the proportion of new assessment notices that are maintained following an appeal or litigation.

2. BETTER OVERSIGHT OF PROVISIONS RESPECTING TRUSTS

A trust is an entity that has the capacity to hold property rights on all tangible and intangible property for the benefit of one or more persons called the beneficiaries.

The *Civil Code of Québec* defines a trust as an autonomous special-purpose fund that is separate from that of the settlor, the trustees and the beneficiaries. The trust is a concept that stems from English law, introduced into the *Civil Code*.

It offers several advantages from a legal standpoint, which explains its popularity. A trust allows flexibility in wealth management, the possibility of protecting assets against financial setbacks, and control over remittances to the beneficiaries.

2.1 Impact of trusts on the taxation system

From a fiscal standpoint, a trust is deemed to be an individual: the rules governing individuals' liability to Québec tax apply to trusts.

Briefly, a trust is taxed as an individual on its income, from which certain expenses may be deducted.

— If a trust resides in Québec on the last day of the taxation year, it is subject to Québec tax on its taxable income except for income from an enterprise attributable to an establishment located in Canada outside Québec.

— Conversely, if a trust resides in Canada outside Québec on the last day of the taxation year, it is subject to Québec tax on its income from an enterprise attributable to an establishment located in Québec.

— The current tax rules now stipulate that, unless otherwise indicated, the amount attributed by the trust and included in the income of a beneficiary is deemed, for the year, to be income of the beneficiary from a property that is an interest in a trust.

Almost without exception, a trust may deduct from its taxable income a portion of the income paid or payable to a beneficiary during the year. It is the beneficiary who is taxed on the income, unless the trustee decides that the trust is taxed instead.

The federal government adopted the "21-year rule" to periodically tax the capital gain of trusts. Under the rule, the capital gain accumulated without being realized is taxed at least every 21 years.

Québec adopted a similar provision to harmonize its regime with the federal regime.

By virtue of its very flexibility, the concept of a trust allows in certain situations to limit the taxation in Québec of certain income and is, notably, used for this purpose. In Québec as in Canada, the governments have thus had to define provisions aimed at preventing certain strategies designed for this purpose.

Recent amendments to tax legislation governing trusts

In recent years, federal and Québec tax authorities have focused on the taxation of trusts, more specifically the flexibility that this vehicle offers from the standpoint of tax planning.

Amendments have, therefore, been announced to federal and Québec tax legislation to enable tax authorities to obtain more information on trusts and to limit the benefits inherent in certain planning schemes.

Some of the most recent amendments are briefly described below.

Amendments to Québec tax legislation

March 20, 2012 Budget Speech and November 20, 2012 Budget Speech

- Modification of the tax rate on inter-vivos trusts such that it corresponds to the highest rate applicable in the calculation of personal income tax.
- Taxation in Québec at a rate of 7.05% of inter-vivos trusts non-resident in Canada on the property income derived from the leasing of immovables located in Québec and used principally for the purpose of earning or generating gross income that constitutes a rent.
- Deemed disposition of immovables located in Québec and used principally to earn or generate gross income that constitutes a rent when the inter-vivos trust non-resident in Canada that is the owner becomes a resident of Canada.

To enable Revenu Québec to obtain a fuller picture of trusts that engage in activities or possess rental buildings in Québec and to validate their compliance with taxing statutes, the Minister of Finance announced the addition of new situations in which a trust would be obliged to file a return to Revenu Québec:

- an inter-vivos trust, non-resident in Canada that owns a rental building located in Québec, whether or not it has tax payable;
- a trust subject to Québec tax that did not have to file a tax return if it satisfies any of the following conditions:
  - it has deducted in the calculation of its income an amount attributed to a beneficiary, regardless of the beneficiary's place of residence;
  - it resides in Québec and owns property in respect of which the total costs indicated exceed $250 000;
  - it does not reside in Québec and owns property that it uses to operate a business in Québec in respect of which the total costs indicated exceed $250 000;
- a trust that resides in Canada outside Québec and owns an immovable located in Québec used principally to earn or generate gross income that constitutes a rent.

Recent amendments to tax legislation governing trusts (continued)

Amendments to Canadian tax legislation

Tax legislation has been amended in order to limit loss trading (and other tax consequences).

The application of thin capitalization rules has been extended to Canadian-resident trusts and Canadian non-resident trusts that engage in activities in Canada.

The tax base on split income has been broadened to take into account other planning schemes.

The tax rate applicable to testamentary trusts and estates (after a 36-month time limit after the succession has been opened) has been amended such that the maximum tax rate applicable to individuals applies to such trusts and estates as it does to inter-vivos trusts.

Choices[1] allow a trust, when the trust's income becomes payable to a beneficiary, to treat such income as not having been paid or having become payable to the beneficiary. The beneficiary thus does not have to include such income in the calculation of his income and the amounts are subject to self-assessment by the trust. On August 29, 2014, the federal finance minister made public legislative provisions aimed at limiting such choices. The provision was assented to on December 16, 2014. Accordingly, the trust's choice is only valid for the portion of income that has become payable to a beneficiary that allow the trust to use its tax accounts, e.g. its losses. Any other income that becomes payable to a beneficiary must be included in the beneficiary's income.

1 Paragraph 104(13.1) and 104(13.2) of the federal *Income Tax Act*.

❑ Three impacts that attracted the committee's attention

The committee has been made aware of several impacts of trusts on the Québec taxation system. Three such impacts attracted, in particular, its attention:

— shifting the tax base outside Québec;

— circumvention of the concept of associated companies;

— splitting income from corporations.

2.2 Shifting the tax base outside Québec

The question of shifting the tax base outside Québec led the committee to wonder about trust residency.

According to the courts, residency is located in the jurisdiction where the management and control centre of the trust is located. In practice, it may be easy to ensure that the trust resides in a low-tax-rate jurisdiction.

Locating the residency of a trust outside Québec is thus one means used to shift the taxation of income outside Québec to jurisdictions that apply lower tax rates.

Examples of the use of trusts to shift the tax base outside Québec

Below are two examples of the use of trusts that shift certain income outside Québec.

First example

Tax planning uses a Canadian-resident trust to promote shifting income from a business operated in Québec. In principle, the income from a business in Québec should be taxed in Québec regardless of the residency of an individual or the trust earning the income.

The planning scheme ensures that the business income earned by the trust is payable to the beneficiary of the trust and will be taxed in the beneficiary's hands as income from a property that is an interest in the trust. Business income is thus transformed into property income in the hands of the beneficiary. It is taxable in the province of residence of the individual who is the beneficiary of the trust operating the business.

Second example

A tax planning scheme uses a Canadian-resident trust in a province with a lower tax rate to acquire a commercial building located in Québec in order to earn rental income from it. Given the structure and services offered by the building's owner, the income from such property may be qualified as property income.

Under the agreement concluded between the provinces on the income distribution of individuals, including trusts, for the purposes of taxation, the property income earned by an individual, including a trust, and the taxable capital gain that he may realize when the property is disposed of are taxable in the province of residence of the individual, or the trust, at the end of the taxation year, regardless of where the property is located.

❑ Several worrisome situations

Several situations remain worrisome and are engendering a loss of tax revenues for Québec.

Such is the case with tax planning schemes that limit the taxation in Québec of certain income such as income from businesses operated in Québec or rental income from commercial buildings located in Québec.

Tax planning schemes also limit capital gains taxation stemming from the disposition of such buildings.

In recent years, the Québec government has adopted tools to obtain a more complete picture of trusts that engage in activities or possess rental buildings in Québec and ensure that they abide by the taxing statutes.

To put an end to the worrisome situations that stem from the use of trusts to shift the tax base outside Québec, the committee recommends that the Québec government initiate discussions with the federal government and the provinces:

— to agree to amend the tax provision stipulating that the income payable by a trust to its beneficiaries be deemed, almost without exception, to be income from property;

— so that property income from the rental of certain buildings and the capital gains from their disposition be subject to income tax according to the location of the buildings rather than trust residency.

Should the discussions with the federal government and the provinces fail to produce the desired results, the committee recommends that the Québec government contemplate the possibility of acting unilaterally in order to make liable for tax income from a business operated in Québec and rental income from a building located in Québec. Québec could grant a tax credit to offset the tax collected by another province.

More specifically, the existing rules would be amended as follows:

— The Québec taxation system applicable to trusts falls under the Canadian taxation system and the federal government and the provinces should agree to amend the provision stipulating that the income payable by a trust to its beneficiaries is deemed, with some exceptions, to be income from a property.[59]

— The income payable by the trust to its beneficiaries would thus preserve the same nature in the hands of its beneficiaries, with the corresponding tax rules.

It would be desirable for the federal government and the provinces to agree on the coordinated amendment of the income distribution rules in the case where certain trusts such that their property income from the rental of certain buildings located in a province and their taxable capital gains from the disposition of such buildings be liable for income tax according to the location of such buildings and not according to trust residency.

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[59] Presumption of section 651.1 of the Québec *Taxation Act* and paragraph 108 (5)b) of the federal *Income Tax Act*.

2.3 Circumvention of the concept of associated companies

Under the Québec taxation system, certain rules are based on the concepts of "non-arm's-length relationships," "associated companies" and "related persons."

The concepts can be circumvented by using trusts created within a corporate group, which can mean that the assistance granted to certain entities in a corporate group exceeds what is desirable.

As for the use of trusts to circumvent the concept of associated companies, the Québec government has already adopted, under certain circumstances, provisions that stipulate that the trust is deemed to be a corporation, for the application of the association rules, and the beneficiaries of the trust are deemed to be shareholders of the corporation.

The committee recommends that similar provisions be adopted to interpret the concepts of "non-arm's-length relationships," "associated companies" and "related persons" when a trust is used within a corporate group.

The concept of associated companies

While the concept of associated companies is complex, it can be defined briefly.

Two companies are said to be associated companies when:

- one company directly or indirectly controls the other company;
- the same person or the same group of persons directly or indirectly controls the two companies;
- the person who directly or indirectly controls one of the companies is related to the persons who directly or indirectly controls the other company and one of the persons holds at least 25% of the shares issued of a class (not excluded) of the share capital of each company;
- the person who directly or indirectly controls one of the companies is related to the each member of the group of persons that directly or indirectly controls the other company and this person holds at least 25% of the shares issued in a class (not excluded) of the share capital of the other company;
- each member of the related group that directly or indirectly controls one of the two companies is related to all of the members of the related group that directly or indirectly controls the other company and one or several persons who are members of the related groups hold alone or together at least 25% of the shares issued in a class (not excluded) of the share capital of each company.

Other legislative provisions allow for certain companies to be related among themselves.

Several tax consequences stem from the fact that companies are deemed to be associated. In particular, they must share the small business deduction and the limit on allowable expenses for the purposes of the scientific research and experimental development tax credit.

2.4 Splitting income from corporations

Trusts are often used to split the income of corporations. This observation led the committee to more comprehensively broach the question of corporate income-splitting.

Income-splitting consists in sharing income among the members of the same family in order to take advantage of progressive tax rates and thereby reduce the amount of tax payable.

❑ The use of trusts

We have noted that trusts are frequently established in order to take advantage of corporate income-splitting, which would normally be more difficult if the trusts did not exist.

For example, ownership by children under 18 years of age of the shares of a company raises questions concerning the rights that such children may exercise by owning the shares directly in their own name. What is more, it may not be desirable for children of legal age and the spouse of the shareholder to directly own shares in the company.

The creation of a trust to own shares in a company may therefore allow greater flexibility by transferring to the trustees the exercising of certain rights related to share ownership. It is in this context that minor children, children of legal age and the spouse are often named as beneficiaries.

This form of ownership allows for the distribution of income—a dividend or a capital gain—by the trustees to the beneficiaries of the trust.

This form of tax planning has for many years become increasingly widespread in Québec. Since 2001, a number of professionals have been able to engage in their activities through a company. When they incorporate, numerous professionals set up a trust that owns the shares of the company, which enables them to share the income with members of their family.

❑ Current legislation

At present, federal and Québec taxing statutes make provision for a special tax on split income for taxpayers under 18 years of age to prevent certain forms of splitting.

The tax on split income is also called the "kiddie tax." It applies, in particular, to dividends received from private corporations and to capital gains on the disposition of the shares of a private corporation in favour of a person dealing on a non-arm's length basis.

When the rules apply, the kiddie tax is calculated at the highest marginal rate of the personal income tax rate schedule.

■ Proposed changes

The committee recommends that the government initiate discussions with the federal government to amend the rules in force concerning income-splitting and, more specifically, the concept of split income.

The committee is proposing to extend the tax on split income for minor children to children of legal age and the spouse, with the exception of those among them who participate in the company's activities.

Making such taxpayers liable for the tax on split income would significantly reduce certain types of planning schemes that rely on income-splitting.

❑ Income-splitting and the lifetime capital gains exemption

Income-splitting, especially by means of trusts, raises the possibility of adopting tax planning schemes that allow the beneficiaries to take advantage of the lifetime capital gains exemption.

According to tax statistics, for the 2009, 2010 and 2011 fiscal years, the lifetime capital gains exemption claimed by taxpayers under 20 years of age stood on average at $90 774, compared with $53 556 for applicants overall.[60]

When a corporation qualifies as a corporation operating a small business, the sale of the shares of the latter by a trust may make it possible to multiply the lifetime capital gains exemption. Indeed, if the capital gains from the trust or a portion of such gains are attributed by the trustees to the beneficiaries, the latter may take advantage of the capital gains exemption provided that certain conditions are met.

Such income-splitting could be possible with the spouse, the minor children and the children of legal age of the shareholder of the corporation.

■ Proposed changes

The committee recommends that the government initiate discussions with the federal government to limit certain planning schemes concerning the lifetime capital gains exemption.

Accordingly, the committee is proposing that a minor child no longer be allowed to benefit from the lifetime capital gains exemption when shares are transferred to a person with whom the minor child does not have a non-arm's-length relationship in order to limit the attendant tax planning schemes.

Moreover, the lifetime capital gains exemption should only be available to children of legal age and the spouse who participate in the activities of a family business.

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[60] Ministère des Finances du Québec, *Statistiques fiscales des particuliers – Année d'imposition 2009*, *Statistiques fiscales des particuliers – Année d'imposition 2010* et *Statistiques fiscales des particuliers – Année d'imposition 2011*, in Table 3.

❑ The importance of information returns

To conclude, it bears noting that for several years Québec tax legislation has obliged trusts to produce an information return in specific situations when the trusts do not have to file a tax return, which enables Revenu Québec to obtain a more complete picture of trusts.

This obligation is a key factor for the implementation of the committee's recommendations concerning income-splitting.

APPENDIX 1: ANALYTICAL GRID USED TO EVALUATE TAX EXPENDITURES

In this appendix, the committee explains the approach that it adopted to pinpoint the revision of tax expenditures in respect of personal income tax, corporate income tax and consumption taxes.

❑ Tax expenditures

Tax expenditures has a broad meaning, i.e. the measures introduced in legislation to lighten the tax burden of taxpayers that reduce the government's tax revenues.

Tax expenditures can target specific groups of taxpayers, defined activities or be applied across-the-board.

There are nearly 300 tax expenditures under the Québec taxation system.

1. THE FOUR MAIN COMPONENTS OF THE ANALYSIS

The committee identified four main components to analyze the entire array of tax expenditures:

— the field of intervention;

— coherence with other tax measures and existing programs;

— interaction with the federal system;

— the measure's relevance.

The committee is presenting the four components in the form of the questions that they raise.

❑ Under which field of government intervention does the measure fall?

In the perspective of a systemic analysis of taxation, it is important to obtain an overall picture of the measures according to the field of government intervention under which they fall. That a measure does not fall under any field of government intervention is not in itself sufficient reason to recommend its abolition but must therefore raise questions.

The committee recognized several fields of intervention that encompass the Québec government's key missions.

The fields of Québec government intervention through taxation, as identified by the committee

Measures that affect individuals above all

1. Recognition of life circumstances and basic needs
2. Recognition of health needs
3. Support for families with children
4. Support for disadvantage people
5. The work incentive
6. The saving and investment incentive
7. The encouragement of education and training
8. The encouragement of gifts
9. Support for culture

Measures that affect corporations above all

1. Assistance for research and development
2. Support for innovation
3. Support for exports
4. The encouragement of investments and growth in productivity
5. Support for struggling businesses
6. Support for growth and the creation of value
7. Support for regional development
8. Support for entrepreneurship
9. Support for job creation

Measures that affect individuals and corporations

1. Support for economic development
2. The encouragement of sound environmental practices

❑ Is the measure coherent with other tax measures or existing programs?

The analysis of a measure must be conducted bearing in mind the other measures under the Québec taxation system, existing programs and other tax regimes that may apply.

In particular, we must:

— avoid duplications in the assistance provided, in particular between taxation and budgetary programs;

— ensure coherent treatment according to the taxation system that applies, such as between an employee and a self-employed worker;

— avoid double taxation.

A change in tax expenditures must not eliminate a measure aimed at avoiding double taxation. Indeed, the elimination of double taxation is a basic concern under the taxation system since taxes paid in other jurisdictions must be recognized. In particular, the integration mechanisms between personal income tax and corporate tax must be maintained.

❑ How does the measure interact with the federal taxation system?

The possible interaction of a measure with the federal taxation system must be considered in the analysis of the measure.

The first interaction factor to be considered is the overall attainment of the objective. Accordingly, it is essential to evaluate not only the measure itself but also the measure combined with federal assistance, where applicable. From this initial interaction factor stems a reflection on whether or not it is necessary to enhance federal assistance where it exits or the need to offer a different Québec-specific feature.

The second interaction factor concerns harmonization. It is a question of ascertaining whether the Québec measure is harmonized with the federal regime and of asking whether such harmonization is desirable or necessary.

❑ Can the measure be deemed relevant?

Unlike the first three analysis criteria, the last one is decisive. It is readily apparent that there is no reason to maintain a measure that is deemed to be irrelevant.

Four conditions determine such relevance.

— The first condition concerns the measure's importance in relation to government intervention overall aimed at the objective in question.

  For example, a very limited tax measure added to significant budgetary funding often has very little impact.

— The second condition is the attainment by the measure of the objective.

  In particular, the attainment of the objective can be judged from the standpoint of the number of beneficiaries of the measure or whether or not the clientele targeted makes use of the measure. A little-used measure or a measure used by beneficiaries who are not the targeted clientele risks being irrelevant.

— The third condition applies instead to the very need in respect of which the measure was implemented and to the relevance of such a need.

  Numerous tax measures were introduced several years ago without a reassessment of the need that they satisfy. Over time, it is possible that there is no longer any rationale for the measure in the current context.

— The fourth condition is the possibility or impossibility of doing better with revenue that the government has relinquished because of the tax expenditure.

  A measure should not be maintained if the same objective can be attained at lower cost by different means, in particular through a budget measure. A measure should not be maintained if the amounts in question deprive the government of the possibility of satisfying other priority needs.

2. SPECIFIC CONCERNS

Beyond the four main components of its analyses, the committee identified concerns that are specific to tax expenditures pertaining to each of the three fields of taxation:

— personal income tax;

— corporate income tax;

— consumption taxes.

❑ Specific concerns pertaining to revision of tax expenditures related to personal income tax

The committee identified three concerns pertaining to tax expenditures related to personal income tax.

— Equitable treatment and the recognition of income in the determination of the tax common base.

— Oversight of the universal nature of certain measures.

— Recognition of expenses incurred to earn income.

■ Equitable treatment and the recognition of income in the determination of the tax common base

Theoretically, all individuals should be taxed according to their total income, which constitutes the common tax base. In reality, the *Taxation Act* defines reductions and identifies non-taxable income, which alters the common tax base by converting total income to net income or taxable income.[61]

Such impact on the common tax base affects the fairness of tax: two taxpayers with equivalent incomes will not pay the same tax if one of them benefits from deductions or the non-taxation of part of his income.

Indeed, there are now different forms of income under the taxation system that are treated advantageously either through different forms of non-taxation or by the existence of deductions that reduce taxable income.

Non-taxation means that certain income is simply not recorded on the income tax return. Accordingly, non-taxation, like deductions and exemptions, alters the basis for calculating eligibility for socio-fiscal transfers.

It is usually net income, not total income, that serves as a basis to calculate the granting of tax assistance or socio-fiscal transfers.

Almost without exception, all income should be declared and recognized in the calculation of socio-fiscal transfers. The tax regime can nonetheless recognize the possibility of partially or fully taxing or not taxing such income.

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[61] The Québec taxing statute uses the intermediate concept of net income to determine access to certain tax assistance or certain socio-fiscal transfers. Accordingly, certain deductions, mainly those that recognize expenses incurred to earn income, apply to the computation of net income, while others are added subsequently to calculate taxable income.

■ Oversight of the universal nature of the measure

At present, certain measures are reducible according to income while other so-called universal measures are not. Universality recognizes a given situation, irrespective of the taxpayer's income.

In certain instances, the authorities may seek to abolish the universal nature of a measure by limiting the assistance granted solely to taxpayers whose incomes fall below a certain threshold. In this way, they recognize that a specific situation demands government assistance only when the taxpayer's financial situation requires support.

In such a case, the reducibility of the assistance should be regulated. It should apply beyond a given income. The withdrawal of the universality of certain measures must then take into account the impact of this change on the implicit marginal tax rates.

■ Recognition of expenses incurred to earn income

A number of measures under the taxation system seek to recognize expenses incurred to earn work income.

Separate measures apply to employees and to self-employed workers, since their situations differ. However, the measures must maintain equitable treatment.

Changes made to tax measures should not compromise equitable treatment.

There are also measures under the taxation system aimed at recognizing the financial expenses incurred to produce income, whether business income, rental income or investment income. The committee is of the opinion that the deduction of expenses incurred to produce income must reflect the tax treatment of such income. The rule observes the principle of neutrality by treating different forms of investment in the same way.

❑ Specific concerns pertaining to revision of tax expenditures related to corporate tax

The committee identified two concerns pertaining to tax expenditures related to corporate tax:

— the type of business that the measure covers;

— guidelines that structure the measure's generosity.

■ The type of business that the measure covers

In its analyses, the committee took into account that the forms of support to be adopted may diverge depending on the type of business targeted by a tax measure.

The business is defined here according to two variables, i.e. its size and its area of activity.

The types of business that the committee identified	
According to size	**According to area of activity**
1. Businesses in the start-up phase	1. The new economy
2. Small or medium-sized businesses	2. Manufacturing
3. Large enterprises	3. The forest sector
	4. The mining sector
	5. Culture
	6. Agriculture
	7. The financial sector
	8. Specific industries

■ The guidelines that structure the measure's generosity

This concern refers to the relative amount of the assistance offered, which may be deemed its generosity, and makes it possible to question its application parameters.

The question is to determine whether the measure is properly structured, i.e. if it is designed to offer assistance that does not exceed what is necessary or desirable.

Three guidelines are thus examined:

— the reasonable nature of the amount of the tax benefit that the measure accords;

— the duration of the measure or the period of eligibility, which may or may not be limited;

— the refundable or non-refundable nature of the measure.

❑ Specific concerns pertaining to revision of tax expenditures related to consumption taxes

Lastly, the committee has examined two concerns pertaining to tax expenditures related to consumption taxes:

— the QST-GST harmonization agreement;

— the measure's level of administrative complexity.

■ The QST-GST harmonization agreement

In the wake of the agreement reached in 2012 between the Québec and federal governments, Québec must maintain a certain uniformity in the QST system in relation to the GST system.

■ The measure's level of administrative complexity

Even if, at first sight, a tax expenditure may not seem warranted, it must be maintained if its abolition imposes excessive administrative complexity. Indeed, it would be unjustified to tax a good or service if the attendant income did not warrant the administrative complexity necessary to manage and collect the tax.

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